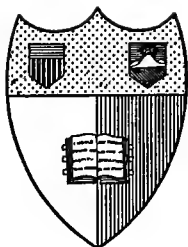


THE TAXATION OF UNEARNED INCOMES

HARRY GUNNECK BROWN



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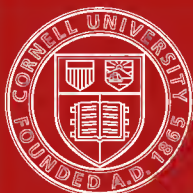
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TWO ESSAYS ON THE TAXATION OF UNEARNED INCOMES

BY

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"Principles of Commerce"

"Transportation Rates and Their Regulation"

"The Theory of Earned and Unearned Incomes"



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THE TAXATION
OF
UNEARNED INCOMES

Whence shall come the new barbarians? Go through the squalid quarters of great cities and you may see, even now, their gathering hordes. . . .

It is the delusion that precedes destruction which sees in the popular unrest with which the civilized world is now feverishly pulsing, only the passing effect of ephemeral causes. Between democratic institutions and the aristocratic adjustments of society there is an irreconcilable conflict. Here in America, as there in Europe, it can be seen arising.

HENRY GEORGE

In Progress and Poverty (1879).

It is, then, for some one to construct an economic science adapted not only to the requirements of the facts but to the need of their amelioration. To this end Economics must cease to be a system of apologetics, the creed of the reactionary, a defense of privilege, a social soothing sirup, a smug pronouncement of the righteousness of whatever is—with the still more disastrous corollary of the unrighteousness of whatever is not. . . .

When, in short, we have changed our calling from the painting of utopias and the capitalizing of dreams, and have, as scientists, brought ourselves somehow into touch with fact, the prosperous may no longer deride us or the disinherited curse. There will need be no laughing then anywhere, and if there be cursing, it will have changed its source.

H. J. DAVENPORT OF CORNELL UNIVERSITY
In The Economics of Enterprise.

THE TAXATION OF UNEARNED INCOMES

I

EARNED AND UNEARNED INCOMES, INEQUALITY AND TAXATION

§ 1

The Conflict of Class Interests

The task confronting us through these essays is to discover whether taxation can advantageously be used as a chief tool in the attainment and perpetuation of economic democracy, and, if so, what system of taxation is best for the end in view. Such an inquiry as is here proposed, may well involve, as a first step, a consideration of the nature of the economic system in and through which the people of the modern world carry on their struggle for the means of existence. For unless we suppose this system to be the best possible, it ought clearly to be either modified in greater or less degree or superseded. And whether the former or the latter change can be most effectively brought about or can be brought about at all, by taxation, as well as whether either sort of change ought to be brought about by any method, can hardly be intelligently decided without an understanding of the fundamental nature of the system of which the modification or supersession is contemplated.

It is the failure clearly to comprehend the nature of the faults of the existing economic system which has, in large part, made protest and even revolt ordinarily so futile in really improving the conditions of life for the common man to the extent that might else be possible. Pro-

testant or revolutionary groups have to meet, always, the more or less solid opposition of the groups whose interests are threatened by change and who know well how to protect these interests. Individual members of the conservative groups may be liberal-minded enough to favor reforms of a palliative sort, especially as many of these reforms seem likely to cost them nothing. But few members of the conservative, property-owning class seem able to contemplate without a sense of shock or a feeling of indignation any proposal seriously to disturb in its fundamentals that order or system of things (the existing system of private property) in the meshes of which they have been bred and to which they seem mainly to owe their material well-being. To the support of that system in general, they will usually rally. We need not suppose that they understand it in the sense of being able to contemplate philosophically its faults and its virtues. But they are not devoid of an understanding of how it works to maintain them and of how to make the most, in argument, of certain of its apparent advantages. Reputable economists in plenty are at hand to support them and to make plausible by manifold arguments of ingenious intricacy the claim that the present scheme of things is good for the masses and that, anyway, the views of those who attack it are associated with this or that "now generally discredited" doctrine and so "fall to the ground" and "need not be further considered." Young economists not infrequently get the impression from their teachers that certain views are commonly rejected by reputable members of the craft, and deem it not worth while to investigate them. Subconsciously they come to feel that these views would be likely to put them "outside the pale." For it is not alone through inducing the

fear of loss of teaching positions (although this is a sufficiently common means) that the defenders of the existing régime control the teaching of economic principles and problems.

A task more difficult than that of the defenders of the present system confronts those iconoclastic dissentients who must, to be successful, get another system put in its place. These dissentients have to rally the elements of discontent, of which, presumably, they are a part, to the support of a more or less definite program. But these elements of discontent are in large part composed of the relatively untrained masses; hence they are even less likely than the sufficiently ignorant propertied classes to understand the inner nature of those arrangements which most of the propertied classes defend and which it appears to be the interest of the masses to attack; and they can not be expected to have a very intelligent comprehension of the kinds of change needed or of the type of system which may best be substituted for the one we have. The protesting masses are likely to be attracted by something which sounds radical, which appears to uproot the whole present scheme of things but which, in fact, can not be made to work successfully in the existing state of human nature. They are too likely to be the prey of the demagogue or the fanatic. With a sense of having been unjustly ground down by an economic system which has made others prosperous, they are likely to favor absolute equality of incomes, regardless of differences in efficiency, or to follow a Marxian philosophy and wish to terminate all incomes from property *just because* these are not *labor* incomes. If the propertyless masses succeed in acquiring temporary control through revolution, they are likely to blunder from one radical step to another

without adequate regard to those elements of human nature which make some things workable and others not, until the general turmoil and poverty and disorganization discredit them far enough to put their deposed masters back into the economic saddle.

Again, oftentimes a group of the propertied classes is enabled to use the ignorance and discontent of the propertyless as a means of further lining their own pockets even at the expense, partially, of the rest of the propertied classes, as well as at the expense of the masses. Thus, the tariff protected interests of a country, through their organizations and organs, make it appear to millions of workingmen that free traders are aristocratic enemies who would take the bread from their mouths to benefit foreigners and that a high tariff system is a necessary means of providing workingmen with jobs. Or those property owners who are in debt and who can gain at the expense of other property owners (their creditors) by a depreciation of the monetary standard, may sometimes succeed in rallying to their support millions of wage earners to whom such depreciation may mean, chiefly, increased cost of living with no immediate corresponding rise of wages.

It is not only the propertyless masses who can be thus put into a false position. Class prejudice sometimes makes groups of the propertied classes, whose interests, in a specific reform, are the same as the interests of the masses, nevertheless oppose such a reform. And so, in the case of a protest against various abuses in the system of property, which, if effective, would limit mainly the incomes of the wealthy few, these few are able to lure to their support thousands of small property owners who might even stand to gain by the proposed change, but

whose prejudices are those of the larger owners of property and who are easily roused to a belligerent spirit by anything which can be made to appear to them as a threat against a system of things which they have learned to regard as sacred.

Hence, many of the great mass movements which seem to be democratic movements, lose themselves in fallacies and confusions and never even temporarily gain their objectives or, if their objectives *are* gained, temporarily, become soon discredited and fall back out of the rays of power and into obscurity. Real democracy is, therefore, to the aspiring masses, as is the mirage to the worn traveller in the desert—a hope, whose realization appears perpetually to recede. Real democracy, in the circumstances of class interest and class prejudice, must wait upon some development of intelligent understanding of the economic system we now have and of the economic forces at work in that system, on the part of those who are its victims. For, so long as the victims of the existing economic system do not understand the faults of the system against which they protest, well enough, specifically enough, and discriminatingly enough to make workable reforms, so long as they are intellectually incapable of doing aught but lumping together for elimination unlike types of incomes, and so long as their revolts are likely to be guided by a short-sighted selfishness, to be directed by demagogues, fanatics and fools, and to result in a turbulence and economic breakdown which brings poverty even to themselves and discredit to their movement, worth-while reform is hardly to be expected or hoped for. Aristocratic economic relations must probably continue, even if they coexist incongruously with democratic political institutions. Indeed, the exploited

masses are ordinarily in large part the dupes of the privileged interests as well as of their own ignorance, and support, through their own prejudices and their own votes, those very economic policies by which they are laid under tribute.

§ 2

*The Price System and the Specialization of Producers*¹

We have now to analyze the existing economic system so as to see by what processes it works and to what effect. This system is sometimes called the *price* system (a term which would doubtless continue to fit even if considerable changes were made in economic arrangements) presumably because within its sway almost everything is the subject of purchase and sale at a price. Not only food, clothing, furniture, etc., and buildings and lands, but labor services, the use of land, the use for fixed or indeterminate periods of sums of capital, are commonly bought and sold. Prices are the inducements by which men are persuaded to dispose of goods, to lend, and to produce goods for disposal. Money is an intermediary in the exchange of any kind of goods for any other kind. We produce and sell one or some things in order that we may buy other things.

The price system, whether as we know it or as some variant of its present form, is a system which leaves those within it largely free to engage in such occupations and produce such goods as they choose. They may, in-

¹ Cf. the Author's book on *The Theory of Earned and Unearned Incomes*, Columbia, Mo. (The Missouri Book Co.). 1928, Chs. I and II.

deed, be often subject to the compulsion of circumstances but they are not subject to any other compulsion. Coercive systems of industry are not unknown to historians and to dreamers of Utopias. Slavery was, and is, coercive. Feudalism, with its accompanying serfdom, was coercive to the serf. The caste system of India is coercive. And any variety of socialism which, in the desire of its apostles to avoid the alleged evils of competition, should *place* men in their jobs, would be coercive. Social reformers must, in fact, make their choice between some form of voluntary selection of occupations, which inevitably means competition for the apparently preferable places, or coercion. There is no other possibility.

It is not difficult to see that a voluntary system must be in some degree a competitive system. If, in a system which allows choice of occupations, one line of industry pays better, all things considered, than another line, those persons engaged in the second line are at liberty to enter the first. But to enter it and sell their product they have to bid down its price, i. e., compete. They then become buyers of what they previously produced and to get this they may have to bid up its price. Even a socialistic government which should direct all industry must either *coerce* its subjects into their respective lines of work or must *so apportion the rewards in different lines of production* as to make voluntary choice yield the desired proportions of various kinds of goods. In other words, the relative amounts of potential competitive offering of services in different lines of production, must be taken account of. Otherwise the system would break down.

Whether such a scientific proportioning of rewards as would be necessary for the successful working of the scheme of individual choice of occupations, would in

fact probably be adopted by a democratically governed socialist state, or whether groups of the citizens of such a state would inevitably drift into bargaining and log-rolling, directly or through their representatives, for unfairly large returns at each others' expense, or whether socialists could avoid a compulsory centralized direction of industry, we need not inquire. Our present interest lies primarily in understanding the nature of the existing system. In this system men engage in producing those goods which they severally think it pays them best to produce, in order to exchange them, through the intermediation of money or bank checks, for goods which others produce; and if what men get for their production seems too little and what they pay for the goods of their desire seems too much, they have the option of becoming producers of the latter goods of which they have been purchasers, thus tending, by their *competition*, to rearrange the relative prices of these various goods.

The fact that voluntary choice of industry tends thus towards rearrangement of relative prices has led to the statement that competition so affects prices of goods as to make the returns to the persons in any one industry substantially equal to the returns to the persons in any other industry. Such an assertion is true only in an extremely general and indefinite sense. To illustrate the necessary qualifications, let us suppose that A is producing wheat as the best way of getting a living. He might instead produce beets and would do so if that would pay him better. But in view of his individual likes and abilities and the qualities and situation of his land, he can make, perhaps, very much *more* at the business of wheat raising than he could at raising beets. He

may even, if efficient enough, be able to make more money raising wheat than anybody else can make producing beets. Nevertheless there are probably some persons whose abilities or the characteristics of whose land, or both, are such as, at the existing ratio of the price of wheat to the price of beets, would make it more profitable for them to produce beets, and still others who would find it about equally profitable to produce either. These last would shift easily from wheat production to the production of beets or vice versa, according as the first or the second kind of produce rose in price in relation to the other. Those engaged in wheat production will not necessarily receive returns exactly equal to those received in beet production. They may receive either more or less according to the circumstances. Thus, if wheat is much more desired than beets by the community in general, the price of wheat will be high enough to bring into wheat production thousands of persons (and their land or the land they hire) who at a lower price of wheat would have chosen to produce beets. Yet there will still be some who, because of their special aptitudes and their preferences as to kinds of labor or because of the qualities of their land, will continue to produce beets. Their returns will be less than before. The returns of wheat raisers will be greater. But the new condition, like the old, will be one of equilibrium.

Similarly, an increased use of shoes and a diminished desire for hats would, at least for a time, increase the remuneration of shoemakers and decrease that of hat makers. If the only barrier to change of occupation is the difficulty of learning a new trade, wages in the trade for which there is now a greater demand need not indefinitely remain much higher than in the other trade in

order to keep more workers in the former. But if the new work is permanently distasteful to many of those drawn into it in order to satisfy the demand, then the wages paid in it may have to be permanently higher, even if the work involved is to a large number of those engaged in it, the most agreeable work they can find. The persons who would have been in this work, even at the old relation of prices, are therefore fortunate. They enjoy surplus wages or profits above what would have been necessary to induce them to go into the work. They may, and probably will, enjoy larger average incomes than the persons who remain in the other line. And yet there is a sense in which it can be said that incomes in their line are not higher than in the other, viz., that there are still, in the other line, persons who find it, all things considered, preferable.

Such inequality—if inequality it should be called—as results from the conditions above discussed, is *an inevitable concomitant of voluntary choice of industries*. To make incomes equal, under such circumstances, or to reduce the incomes of those in the favored line to what we might consider the average level in the other line, *it would be necessary to make occupations coercive*. Whether or not we can put greater burdens on those who get the larger incomes than on those who, in either line, receive smaller incomes, is a different matter, which we need not now discuss. It suffices, for the present, to point out that public policy can not advantageously be discriminatory as between industries, unless the industry discriminated against is an undesirable one, e.g., the manufacture and sale of harmful drugs, or unless it is, or partakes somewhat of the nature of, monopoly.

There are, however, cases of difference between occupational incomes which ought, in the opinion of many, to be in some way corrected. These are cases from which the element of monopoly seems not to be wholly absent. Thus, there may be many persons in a given line of production, not because the pay is good and not because the work is pleasant but solely because those who are in this line are disqualified by lack of ability or lack of training for engaging in other lines where competition is less intense. The prices of the material goods or the services they turn out will be relatively low because these goods or services are relatively plentiful, yet the labor involved may be difficult and unpleasant. So far as the explanation for the small per capita remuneration received, is to be found in the lack, by many or most of the people concerned, of the innate ability necessary for the performance of other, better rewarded tasks, the difficulty lies in there being a relative surplus of people who lack relatively desirable (in view of contemporary human needs and tastes) physical or mental characteristics. The biologist interested in eugenics would be likely to fear that partly to support such a class from the surplus earnings of citizens whose characteristics were better adapted to the satisfaction of the more important or of relatively inadequately satisfied human wants, might involve counter selection, an undue multiplication of the unfit. There may be, indeed, too much counter selection as it is. If so, that is an added reason for not adopting a social policy calculated to increase it.

But human beings are probably not, innately, so different in ability that *most* of the present inequality can be thus accounted for. There are doubtless very many persons whose natural aptitudes would enable them to un-

dertake better paying work than they are at present engaged in, if only they had the requisite training. Sometimes early disinclination to study and sometimes the cost of education have been the obstacles that have kept them from rising out of the ranks of common labor. If, indeed, learning can be secured only by the children whose parents have large incomes and if large labor incomes can only be secured by those who are able to get considerable training, we have a vicious circle of cause and effect. Perhaps this is one of the reasons—though the need for intelligent citizenship and leadership in a democracy is surely another—why it is generally assumed in progressive democratic countries that a system of public education should keep educational opportunity at least within the possible reach of nearly all. Nevertheless, there are probably limits to the burden which the public ought to be required to assume, even for the spread of education. For one, and a most important, explanation of unequal wages is unequal birth rates. If wage receivers who are unable to earn much because those in their lines are too many, and because the goods or services produced in these lines are therefore too plentiful, were to limit their families, each, to the number they could comfortably support, their excess of numbers, *even if few among them worked up into a "higher" economic class*, would, in a few generations, cease to be a cause of low remuneration. Higher wages in such a group would result from smaller numbers in it. And higher wages, together with smaller families, would enable the members of the group individually and even without public assistance, to give their children better training. But if the masses of people will not practice birth limitation, while certain groups do prac-

tice it in order that their fewer children may be better reared and trained, then there is grave doubt whether the latter class ought to be heavily taxed in order that the children of the former may have equal opportunities. Continuous increase of population, since natural resources are limited, tends towards diminished per capita production. Hence a policy of providing for the training of the children of those who multiply rapidly, by drafting the surplus incomes of those who do not, though it may indeed equalize incomes, is almost certain to equalize them downward; while the spread of birth limitation among the classes which suffer—while others gain—from their surplus of numbers, tends to equalize upward.

§ 3

Earned and Unearned Incomes—Wages and Profits

In the previous section the endeavor was made to explain only the inequality which may result between different occupations or lines of production, in the price system. So far as we discussed wages, our interest lay in the relation of the wages of unskilled to the wages of skilled labor. We did not attempt to show how the interests of different economic classes, e. g., laborers *and* capitalists, in any one line of production are related to each other. The persons connected with the production of each kind of wealth or service are divided into classes or sub-groups having interests more or less diverse. We shall consider these sub-groups as three. There are those who perform the labor, those who provide the capital and those who own the land, used in carrying on the production. The corresponding incomes are wages, interest, and land rent.

The wages of labor are received for labor services. They depend on demand for and supply of labor and, ultimately, on the (marginal) productivity of the labor. If the services of a workman add more to the productivity of an industry than he receives in wages, it becomes profitable to employ him, and demand for his services is likely to result in increasing these wages. (Though custom, prejudice, immobility of labor, and lack of means for exact measurement of the amount and value of work done, may make the readjustment slow and rough.) If, on the other hand, a man's services appear to be of less value than his wages, then these services are not likely to be in demand unless and until the wages fall. Taking the case of a group of wage earners of equal ability, we may reasonably suppose that any establishment which could use their services would tend to employ more of them at a lower wage than at a higher wage, for it would tend to employ them up to such a point that the gain from hiring more was zero. And wages must be low enough so that substantially all the labor force of a community (emigration aside) could get employment among all the manufacturing, mining, farming and other establishments. Without our insisting, however, on all the technical points of economic theory, it should be clear that wages are paid for services rendered, that their amount is fixed by demand and supply, and that demand and supply so operate as to make wages higher when labor productivity is large than when it is small. We have already seen why wages may be higher in one line than in another in connection with our study of the relation of the prices of some goods to prices of other goods. It should be clear, also, that the more efficient workers

in any given line will be able, on the average, to command higher wages than those who are less efficient.

Among incomes from labor ought to be included those returns to the owners and managers of industry, above interest on their capital and rent on their land, which economists sometimes call profits. These are the rewards of self-directed labor, as contrasted with wages the amount of which is more or less contracted for in advance. Hence they are even more sensitive to the efficiency of the worker at his job than are ordinary wages. But they are certainly none the less the rewards of effort and are not to be confused with the income which the employer gets by virtue of his ownership of property.

Incomes from labor are often assumed to have some special justification as distinguished from incomes from property. Socialists, for example, assert that labor alone produces value and argue for the termination of all incomes from property. And while it may be doubted whether this sect, if in control of our economic life, would be very tender with those incomes from labor which we call profits, they would, if consistent, necessarily be more tender with those incomes than with interest or rent.

Whatever may be true of most labor incomes, it is certain that some incomes from labor are unearned, if the test be the giving of a *quid pro quo* to those from whom, in the last analysis, the incomes in question are drawn. When, for example, a group of men successfully form a monopoly in order to raise the price of their goods or services, to the public, above a normal competitive return, the reasonable presumption is that this excess above a competitive return is unearned. So, also, when, though monopoly is not formally or completely established,

methods of business are adopted which are calculated to eliminate even an exceptionally efficient producer, the additional incomes received by those adopting these methods are to be regarded as unearned. So-called unfair competition is in this category. Thus, a business concern may, as the National Cash Register Company was proved in court to have done, misrepresent a competitor's goods;² it may, if it controls the major part of the business in its line, so that most dealers will feel obliged to handle its goods, eliminate smaller even though more efficient producers by ordering dealers not to sell the latters' goods on penalty of not being allowed to handle *its* goods; or such a concern may make arrangements with transportation companies to discriminate in its favor and against its rivals, in the matter of freight rates, thus again, despite the possible superior merit or greater cheapness of the latters' goods, eliminating them from the market. Income secured as a result of such (now, in the United States, outlawed) methods of competition, clearly is not to be regarded as earned.

But the case is different with the owners and managers of a concern which increases its business and displaces many of its rivals by virtue of the superior quality or cheapness of its goods, a superiority resulting from more intelligent selection or use of machinery, better adaptation of tasks to men, better organization of work, or other waste-saving proficiency. Business and income so secured are an index of superior service to the public and are not, as in the cases previously discussed, a badge of dishonor.

² The various methods of unfair competition practiced by this company are described in Seager, *The Principles of Economics*, New York (Holt), 1913, pp. 493-499.

The incomes of employees, like the labor incomes of managing employers, may also be either earned or unearned, according as those from whom they are ultimately derived—usually the consuming public—do or do not receive an equivalent in goods or services.

§ 4

*Earned and Unearned Incomes—Interest*³

Incomes from property may be either from capital or from land. We shall consider, first, those from capital. As with incomes from labor, they may be either earned or unearned. This assertion, of course, runs counter to the socialistic view that interest as such is always exploitation. According to the doctrine of orthodox socialism, labor produces all value. From this premise it is argued that those who perform the labor should get the entire product. Since they do not get the entire product of industry, the present economic system is asserted to be one of robbery. Of course, as a matter of sound logic, it is impossible thus to distinguish between labor and capital. While it may be true that nothing or next to nothing can be produced by capital without labor, it is likewise true that next to nothing can be produced by labor without capital. Labor without buildings, roads, machinery and tools would, indeed, be helpless and might easily perish.

So much the socialist would perforce admit, but he would perhaps reply that, although labor must use capi-

³ In *The Theory of Earned and Unearned Incomes*, Chs. III and IV, the author has attempted a more exhaustive study of interest on capital than is here presented.

tal, capital is but the child of labor, that capital is only an intermediate step between the putting forth of labor and the securing of the full product of labor. This reply, however, hardly gives a full account of the matter. Capital is always a surplus above the needs of present consumption. Hence its creation involves not only labor but also a refraining from the present consumption of the products of labor. In short, the creation of capital involves abstinence, or waiting, or saving. The person who, though he labors never so efficiently, consumes in current gratification all that his labor produces (or an equivalent in other goods for which the goods he has produced are exchanged), adds nothing to the capital equipment of society. The only persons to whom society owes anything for the benefits yielded by capital are those persons through whose saving, as well as their labor, the capital comes into existence. And if an increment of capital adds anything to the annual output of the community's labor force, beyond what this labor force would produce with that much less capital equipment, such an added annual output of industry is certainly made possible by that person or those persons whose saving, whose excess of production over consumption, brought the capital into existence. And, further, provided the person whose production and saving makes possible the existence of the capital, gets, as interest on this capital, no more than the use of the capital adds to the production of goods and services which would have been possible without it, *he cannot be said to rob anyone*, since no one is any worse off than if the accumulator of the capital had never brought it into existence. If the socialist would say, frankly, that, though the accumulator of capital makes possible an addition to the annual product of

industry above what all the labor available and all previously existing capital would otherwise produce, and is in that sense the real producer of this additional annual product, nevertheless not he but the other members of society ought to get this additional product, ought to exploit the actual producer of it, we might disagree with the socialist but we could at least understand him. But to say that labor alone *produces all wealth* is economic nonsense. And in saying this, in the sense in which he does say it, and basing upon it serious conclusions regarding public policy, the self-styled scientific socialist reveals his system as a pseudo-science. In this regard, nearly all types of socialism seem to be on common ground. Interest appears to be anathema to socialists of all or nearly all schools, not merely to those of professed Marxian leanings. And *guild socialism*, the latest fad of many socialist theorists, is no exception.

Nor can the socialist easily distinguish between wages and interest on other grounds, so as to justify one and condemn the other. He cannot, for instance, make an ethical distinction by asserting that wages are a reward for sacrifice and interest a payment not earned by sacrifice. To be sure, saving may be, for many, a pleasure which they would indulge were no interest paid. Particularly may persons whose incomes are large, save considerable amounts for the benefit of their children without being conscious of appreciable present deprivation. But the labor for which wages are paid may also be, in some cases, not only not a sacrifice, but a continuous source of pleasure. There seems to be a notion, among socialists and some others, that the reason why wages are paid and, also, the reason why wages *should be* paid, is because labor is unpleasant. It is true that the greater

unpleasantness of one kind of work than of another, when the latter does not require a more rare type of ability than the former, gives rise to higher pay for the former. But if all work were a delight—as some work is to some workers—those who did the work would not on that account consent to forego their pay. Nor would any employing property owner be able to avoid paying wages for work done, so long as labor was productive, since he would have to reckon with the competition of other employers to whom productive labor would seem worth hiring. It is because labor produces something that wages are paid and not because labor is unpleasant. Similarly, it is because capital and, therefore, in effect, saving, produces with labor more than labor alone could produce, that interest is paid for the use of capital in industry. The time has gone by when sacrifice as such can be regarded as a virtue apart from any beneficial consequences it may produce, or can be regarded as entitled, in itself, to any reward.

It does not follow that all interest is earned any more than that all wages are earned. Capital, as well as labor, may be so used as to produce a disservice rather than a service to the general public. Capital may be invested in the means of corruption, in building up political influence through which the public is exploited, in the tools and machinery of noxious drug making, in the plant of a periodical devoted to misrepresentation. If so, the interest received cannot be said to be earned in the sense in which we are using the term. So far as interest on capital and remuneration of labor are received by persons who do not give for them equivalent service to those from whom such interest or wages are in the last analysis drawn, it would seem that the receipt of such

interest and wages by them should be prevented, if prevention is in any way possible. A democracy can hardly afford to have a privileged class deriving large incomes for disservices or even for negative services.

Under the plan of things laid down by orthodox socialists no individual, as such, would be allowed to own capital to any appreciable extent. Certainly no one would be allowed to own any of the machinery of production. Hence, no individual could have any motive in accumulating capital unless that motive were the common good and he would not actually accumulate it unless the influence of such a motive outweighed the personal and family sacrifice involved. Capital would, therefore, under such a régime, presumably have to be accumulated and maintained by the state. This would mean, in a democratic community, that saving would have to be supported, or at least tacitly agreed to, by a majority of citizens, in order that any saving should be done, while under the present system capital is accumulated even if only one person out of ten or one out of a thousand is willing to make the incident present sacrifice.

Again, such state saving as the socialist would resort to is, for the individual who is not in the majority, *compulsory* saving. He must accept, in present consumable goods, only that part of the wages he would otherwise get, which the majority permits, in order that the remainder should be used for the maintenance or the increase of capital. Or, on the other hand, in case the majority decides against adequate saving, then the individual who would have saved must see the community's productive equipment depreciate and the prospect of a good living for his children progressively decline, without being able to apply any remedy.

It is not the intention to argue that no form of socialism or near-socialism could possibly be adopted which would work differently. Thus, the state might *operate* all industry, but secure its capital from the voluntary saving of its employees, and pay these employees interest based on the per cent. advantage ⁴ of having their capital. Indeed, voluntary choice whether to save or not, coupled with payment of interest in accordance with the utility to the community of the saving, would seem to be consistent with voluntary choice whether to work or not and in what occupation to work, coupled with payment of wages in accordance with the utility to the community of the work done. Compulsion as to saving would appear to comport better with compulsory labor and compulsory assignment to occupations.

Should any sort of quasi-socialized state be at all feasible on the voluntary principle, the main question of expediency would perhaps be as to the efficiency of such a state in serving its citizens economically, in comparison with the efficiency of independent and more or less competing business units. But objection to the private receipt of interest on capital is so fundamental in the doctrine of socialism—including guild socialism—that few socialists are likely to urge any system which permits it.

§ 5

Earned and Unearned Incomes—Land Rent

In beginning a consideration of land rent we may advantageously call attention to a fundamental distinction,

⁴ Marginal advantage, the economist would say.

too often overlooked, between rent and interest. It is sometimes said that the rent of land is no less interest than the return on other capital, since the return on land can be viewed as a given percentage on a given valuation, while, on the other hand, the interest on other capital can be viewed as an absolute amount in dollars per machine or factory, just as land rent is viewed as so many dollars per building lot or per acre a year. But more fundamentally there is a difference, despite the superficial resemblance, between situation rent and capital interest. The return on land should be looked at as an absolute amount measured and determined by the surplus above interest and wages (the surplus over production on the extensive or intensive margin), which can be produced by industry on the land in question. It is not determined by the value of the land. Neither has the value of land as such, i. e., *its situation value apart from improvements*, any relation to any cost of production, since the land was not humanly produced. On the contrary, the value of the land can be arrived at only by discounting its expected future rents or returns at some previously found rate of interest. Thus, a piece of land which would yield \$5,000 per year net rent (above taxes, wages of labor employed, interest on the capital invested in buildings and other improvements, and insurance) would be worth, if interest were 5 per cent., \$100,000. Were the current rate 10 per cent., such a piece of land would be worth but \$50,000.

With equipment of the producible and reproducible kind, however, the relation between capital and income value is not the simple one above outlined. The value of such capital, though not unaffected by the value of its expected services, is very directly related to the cost of

its production. Buildings of a type costing \$5,000 each will hardly be put up to sell for much less, as a rule, by the builders. Nor, so long as the alternative is open to him of supervising the construction of a similar building, will a possible buyer care to pay a great deal more. The value of a building is determined then, in large part, by the expenses, such as wages, of producing the materials and of putting it up; and these wages are determined, in the last analysis, by the existence of alternative lines of activity open to the wage-earners, while the other costs are determined by the alternative uses to which the *land* or *capital* which must be used in producing the materials might be put.

Since the value of produced and reproducible capital is thus in large part fixed directly by its cost of production, the assertion that interest is in large part determined by the rate of productivity of capital does not involve reasoning in a circle. Interest is 5 per cent. because, for one and perhaps the most important reason, capital worth \$10,000 will produce an annual net income of \$500. It therefore appears, to sum up our conclusions thus far, that the value of produced capital depends in a considerable degree on cost of production, that the ratio between the value of capital and its income is an important factor in determining the general long-run rate of interest, and that this rate of interest is an essential element in the valuation of land.

It is but a short step to the conclusion that the accumulators of produced capital may—and in many cases doubtless do—add to the value of the annual aggregate income of society as much as they take out of this income in interest; while the owners of land, as such, contribute no service in return for their income. Where-

as, in the case of produced capital, the public (except in certain cases, numerous enough no doubt, where the capital is wastefully or injuriously used) pays the owner for a service which, without his saving (or the saving of someone whose right to payment has been transferred to him) would not have been enjoyed; in the case of land the payment is made for a benefit which is dependent on no individual's saving or effort and a benefit for which, therefore, no individual is responsible. In the one case the community pays for a service which is actually rendered to it. In the other case it pays people who have, in the capacity in which they are paid, rendered no service.⁵

To avoid any possible misunderstanding, let it be emphasized that land rent as here defined does not mean merely the sum paid by a tenant to an owner, for the use of the land, but equally the amount received by the person who himself uses his own land, in excess of wages for his labor and interest on his capital. This rent comes to him in money when he sells the goods or services which the land produces. He is paid, thus, by others, for benefits which not he but the land renders. The community, in buying from him, pays him for more than the service he and his capital render them.

The nature of land rent and of the influences that

⁵ Professor Edwin R. A. Seligman, whose views regarding the ideal sort of taxation appear to be fundamentally antagonistic to those presented in this book, has, in the opinion of the present writer, signally failed to grasp the distinction set forth above. See his *Principles of Economics*, sixth edition, New York (Longmans), 1914, paragraph beginning at bottom of page 391. For a further elaboration of this and related distinctions, see the succeeding essay on *The Rent of Land and Its Taxation*, § 7.

bring it into existence can not, perhaps, be better set forth than in the following passage from Henry George's *Progress and Poverty*:⁶

"Here, let us imagine, is an unbounded savannah stretching off in unbroken sameness of grass and flower, tree and rill, till the traveler tires of the monotony. Along comes the wagon of the first immigrant. Where to settle he cannot tell—every acre seems as good as every other acre. As to wood, as to water, as to fertility, as to situation, there is absolutely no choice, and he is perplexed by the embarrassment of richness. Tired out with the search for one place that is better than another, he stops—somewhere, anywhere—and starts to make himself a home. The soil is virgin and rich, game is abundant, the streams flash with the finest trout. Nature is at her very best. He has what, were he in a populous district, would make him rich; but he is very poor. To say nothing of the mental craving, which would lead him to welcome the sorriest stranger, he labors under all the material disadvantages of solitude. He can get no temporary assistance for any work that requires a greater union of strength than that afforded by his own family, or by such help as he can permanently keep. Though he has cattle, he cannot often have fresh meat, for to get a beefsteak he must kill a bullock. He must be his own blacksmith, wagonmaker, carpenter, and cobbler—in short, a 'jack of all trades and master of none.' He cannot have his children schooled, for, to do so, he must himself pay and maintain a teacher. Such things as he cannot produce himself, he must buy in quantities and keep on hand, or else go without, for he cannot be

⁶ Book IV, Chapter II.

constantly leaving his work and making a long journey to the verge of civilization; and when forced to do so, the getting of a vial of medicine or the replacement of a broken auger may cost him the labor of himself and horses for days. Under such circumstances, though nature is prolific, the man is poor. It is an easy matter for him to get enough to eat; but beyond this, his labor will suffice to satisfy only the simplest wants in the rudest way.

"Soon there comes another immigrant. Although every quarter section of the boundless plain is as good as every other quarter section, he is not beset by any embarrassment as to where to settle. Though the land is the same, there is one place that is clearly better for him than any other place and that is where there is already a settler and he may have a neighbor. He settles by the side of the first comer, whose condition is at once greatly improved, and to whom many things are now possible that were before impossible, for two men may help each other to do things that one man could never do.

"Another immigrant comes, and, guided by the same attraction, settles where there are already two. Another, and another, until around our first comer there are a score of neighbors. Labor has now an effectiveness which, in the solitary state, it could not approach. If heavy work is to be done, the settlers have a log-rolling, and together accomplish in a day what singly would require years. When one kills a bullock, the others take part of it, returning when they kill, and thus they have fresh meat all the time. Together they hire a schoolmaster and the children of each are taught for a fractional part of what similar teaching would have cost the first settler. It becomes a comparatively easy

matter to send to the nearest town, for someone is always going. But there is less need for such journeys. A blacksmith and a wheelwright soon set up shops and our settler can have his tools repaired for a small part of the labor it formerly cost him. A store is opened and he can get what he wants as he wants it; a postoffice, soon added, gives him regular communication with the rest of the world. Then come a cobbler, a carpenter, a harness-maker, a doctor; and a little church soon arises. satisfactions become possible that in the solitary state were impossible. There are gratifications for the social and the intellectual nature—for that part of the man that rises above the animal. The power of sympathy, the sense of companionship, the emulation of comparison and contrast, open a wider, and fuller, and more varied life. In rejoicing, there are others to rejoice; in sorrow, the mourners do not mourn alone. There are husking bees, and apple parings and quilting parties. Though the ball-room be unplastered and the orchestra but a fiddle, the notes of the magician are yet in the strain, and Cupid dances with the dancers. At the wedding, there are others to admire and enjoy; in the house of death, there are watchers; by the open grave, stands human sympathy to sustain the mourners. Occasionally, comes a straggling lecturer to open up glimpses of the world of science, of literature, or of art; in election times come stump speakers, and the citizen rises to a sense of dignity and power, as the cause of empires is tried before him in the struggle of John Doe and Richard Roe for his support and vote. And, by and by, comes the circus, talked of months before, and opening to children whose horizon has been the prairie, all the realms of the imagination—princes and princesses of fairy tale, mail-clad crusaders and turbaned

Moors, Cinderella's fairy coach, and the giants of nursery lore; lions such as crouched before Daniel, or in circling Roman amphitheater tore the saints of God; ostriches who recall the sandy deserts; camels such as stood around when the wicked brethren raised Joseph from the well and sold him into bondage; elephants such as crossed the Alps with Hannibal, or felt the sword of the Maccabees; and glorious music that thrills and builds in the chambers of the mind as rose the sunny dome of Kubla Khan.

"Go to our settler now, and say to him: 'You have so many fruit trees, which you planted; so much fencing, such a well, a barn, a house—in short, you have by your labor added so much value to this farm. Your land itself is not quite so good. You have been cropping it, and by and by it will need manure. I will give you the full value of all your improvements if you will give it to me and go again with your family beyond the verge of settlement.' He would laugh at you. His land yields no more wheat or potatoes than before, but it does yield far more of all the necessities and comforts of life. His labor upon it will bring no heavier crops, and, we will suppose, no more valuable crops, but it will bring far more of all the other things for which men work. The presence of other settlers—the increase of population—has added to the productiveness, in these things, of labor bestowed upon it, and this added productiveness gives it a superiority over land of equal natural quality where there are as yet no settlers. If no land remains to be taken up, except such as is as far removed from population as was our settler's land when he first went upon it, the value or rent of this land will be measured by the whole of this added capability. If, however, as we have

supposed, there is a continuous stretch of equal land, over which population is now spreading, it will not be necessary for the new settler to go into the wilderness, as did the first. He will settle just beyond the other settlers, and will get the advantage of proximity to them. The value or rent of our settler's land will thus depend on the advantage which it has, from being at the center of population, over that on the verge. . . .

"Population still keeps on increasing, giving greater and greater utility to the land, and more and more wealth to its owner. The town has grown into a city—a St. Louis, a Chicago, or a San Francisco—and still it grows. Production is here carried on upon a great scale, with the best machinery and the most favorable facilities; the division of labor becomes extremely minute, wonderfully multiplying efficiency; exchanges are of such volume and rapidity that they are made with the minimum of friction and loss. Here is the heart, the brain, of the vast social organism that has grown up from the germ of the first settlement; here has developed one of the great ganglions of the human world. Hither run all roads, hither set all currents, through all the vast regions round about. Here, if you have anything to sell, is the market; here, if you have anything to buy, is the largest and the choicest stock. Here intellectual activity is gathered into a focus and here springs that stimulus which is born of the collision of mind with mind. Here are the great libraries, the storehouses and granaries of knowledge, the learned professors, the famous specialists. Here are museums and art galleries, collections of philosophical apparatus, and all things rare, and valuable, and best of their kind. Here come great actors, and orators, and singers, from all over the world. Here, in

short, is a center of human life, in all its varied manifestations.

"So enormous are the advantages which this land now offers for the application of labor that instead of one man with a span of horses scratching over acres, you may count in places thousands of workers to the acre, working tier on tier, on floors raised one above the other, five, six, seven and eight stories from the ground, while underneath the surface of the earth engines are throbbing with pulsations that exert the force of thousands of horses.

"All these advantages attach to the land; it is on this land and no other that they can be utilized, for here is the center of population—the focus of exchanges, the market place and workshop of the highest forms of industry. The productive powers which density of population has attached to this land are equivalent to the multiplication of its original fertility by the hundred fold and the thousand fold. And rent, which measures the difference between this added productiveness and that of the least productive land in use, has increased accordingly. Our settler, or whoever has succeeded to his right to the land, is now a millionaire. Like another Rip Van Winkle, he may have lain down and slept; still he is rich—not from anything he has done, but from the increase of population. There are lots from which for every foot of frontage the owner may draw more than an average mechanic can earn; there are lots that will sell for more than would suffice to pave them with gold coin. In the principal streets are towering buildings, of granite, marble, iron and plate glass, finished in the most expensive style, replete with every convenience. Yet they are not worth as much as the land upon which they rest

—the same land, in nothing changed, which when our first settler came upon it had no value at all.”

But, it may be said, at least many of the present land-owners are persons who have made their savings from what they have earned and have chosen to invest their savings in land rather than elsewhere. Have they not, in their savings, given the community as much value as they draw in rent? The answer may well be that they have given, to that part of the community from whom their rent income is derived, nothing whatever. If A, who has saved \$10,000, uses it to buy a piece of land from B, he is merely paying B for the privilege, previously enjoyed by B, of receiving rent from others for the use of something which neither he nor any other individual produced and the use of which would be equally available had no owner or purchaser of land ever been born. In turn, B has now the \$10,000 of accumulations and it is quite possible that he may use it in some way that will increase the annual product of industry. If so, the community, or some members of the community, will come to be paying B, in interest on capital, for services which, without A's saving, would not have been available, while they will be paying A, in rent, for benefits from the use of land, which are not due to any individual's work or savings. If, before, the community was paying the landowner B a rent while getting no service that could fairly be regarded as coming *from him* now it is making payments to both A and B, as rent and interest respectively, and receiving services in return from only one. If, before, B the landowner was a pensioner to whom the community gave something for nothing, now A has become the pensioner, having bought out B, and is receiving, from the rest of the community, something for noth-

ing. For it should be clearly evident that the \$10,000 paid to B for the land is not a service rendered to C, D, or E, who are the persons that have to pay A for the use of the land. Yet much of emphasis is commonly directed to the assertion that the land-using part of the community ought to pay rent to landowners *because* these landowners have in many cases paid previous landowners for the land and despite the fact that none of the landowners in the series can be said to have rendered any service to those from whom they collect rent payment. In other words, it is asserted that C, D and E ought to be obliged to pay A for no service rendered by him or by anyone, simply because A previously paid \$10,000, not to C or D or E, but to B. Is such a doctrine good utilitarianism? Is its application good social policy?

The same principles apply in the case of such natural resources as coal and iron mines, oil and natural gas wells and power sites. The incomes derived by the owners of the steel trust and others from such resources represent, not service, but the privilege of drawing tribute from the masses as a condition to allowing these masses to make use of the bounty of nature. And those enthusiasts for government ownership of all natural resources, who would have the public buy up these resources from their present owners at current values are simply proposing that the tribute now collected as rent or royalties or dividends shall be given an added sanction and shall be collected in the future as interest on government bonds, to the payment of which the government will be pledged. These natural resources *had no cost of construction*. Their salable value is but the capitalization of tribute. To issue government bonds for them is to

make this tribute rendering more irrevocable, perhaps, than before.

The suggestion has been made (most prominently and effectively by Henry George) that the proper way for the community to deal with all such unearned incomes is to appropriate them to public use by the method of taxation. Whether or not it is possible or desirable to take such unearned incomes by taxation, it should be clear that under the competitive individualistic system of business, no other method of preventing the individual receipt of such incomes is possible. If, for example, when the owner and user of a piece of land were different persons, the owner could be forbidden to charge as rent the surplus, due to advantageous situation, yielded by that specific piece of land above the ordinary returns to labor and capital, the user would proceed to appropriate such surplus. For the fact that the titular owner was not allowed to charge rent would not increase the supply of the goods produced or marketed on the land, and, since price is fixed by demand and supply, would not lower the price of such goods. The producer or dealer who was fortunate enough to have, for nothing, the use of a piece of land so good or so advantageously situated as to give him a larger return than would cover his outlays for wages and interest (including interest on his own capital) and pay for his own time, would not, on that account, sell his output below the market price charged by competitors. But even if he did, his competitors need not lower their price, since there has been no increase in supply or decrease in demand, and since, therefore, the demand on other producers or dealers by consumers remaining unsatisfied, will be as great as before. So, even if the favored producer does lower his

price (as it is safe to say he will not), that would merely pass the favor to a *privileged few* of the consumers of the article. The price could not be reduced to all consumers unless reduced by all other producers.

Furthermore, some of these other producers are producing under conditions such that their labor and capital produce little or no surplus for rent; they may be, for instance, producing on land so poor for the purpose that it yields substantially no surplus.⁷ For them to reduce their price would be to curtail their wages or interest or both. In that case, the attempt to terminate rent would result in lessening other kinds of incomes of the producers of the goods in question and giving these incomes to the consumers of the goods. But these consumers can be no other than the producers of other goods. The injured producers would, therefore, under a régime of free choice of industry, change their occupations and the line of their investment. In short, rent can not be distributed to all consumers of all goods, and to give it to some consumers or to transfer it to tenants leaves as large an element of special privilege in the situation as before. Unless, then, appropriation or taxation of rent, by and for the whole community, is possible, the situation is irremediable under the competitive system of business.

It is perhaps desirable to add an illustration from the economics of railroad transportation. Suppose two cities to be connected by a railroad which runs through a narrow river valley. The traffic is more than this line can handle. Another line is essential but the second has to follow a winding and hilly route. The cost of car-

⁷ Or they may be producing on what economists call the intensive margin.

riage of goods on the second road is necessarily higher. The first road has an advantage of situation. It has an exclusive use of the better route, from which it derives a substantial revenue. For it can and will charge rates as high as does the winding hilly road and will still get plenty of traffic. To require rate reduction of the first road will not transfer this excess income to the general public. For, since this river-valley road cannot carry all of the traffic, some shippers, at least, must pay rates high enough to make worth while the operation of the other railroad. Otherwise it will be abandoned—or never built. And to reduce rates only on the river-valley road is merely to transfer to a favored group of shippers, and not to the whole public, this road's revenue from a natural advantage of situation and from the growth of the community served. The excess income of the river-valley road is situation rent. Taxation of rent by the public can be made to secure, for the general benefit, as much of this income as it is desired to get. Rate regulation can not.

One thing, at least, can be asserted with positiveness, viz., that a tax on the rental value of all land, however used, can neither be shifted from one landowner to others nor from landowners as a class to any other class. The reasons are that such a tax can in no wise limit the supply of land or determine the direction of its use. It cannot decrease the supply of land because land, as we have defined it, is not humanly produced. If it were, a tax on it might decrease the amount of it and so make rent higher. If the landowners who lease their land charge higher rents for its use, tenants will endeavor to economize in the use of land and some of the owners will find their land idle and yielding no revenue. These

will quickly reduce their rent charges, the more so if unused land is taxed at the same rate as used land, since only so can they avoid loss.

We may state the matter convincingly in a somewhat different way if we call attention to the fact that the landowners were presumably, before the tax was laid, charging all the rent they could get. There is nothing in the tax to make tenants willing to pay more or land more difficult to hire. Supposing the tax to apply also to unused land, even more land will probably be on the market for hire than would otherwise be the case, because of the loss to owners in leaving their land idle. Hence, owners cannot raise their rents.

To put the matter in still another way, it may be said that rent is the surplus which can be produced by labor and capital on any piece of land above what that labor and capital could produce on the poorest land in use,⁸ for which no rent is paid and which has either no value or a purely speculative value based on prospects. A tax on the value of land would not increase this surplus yield on the superior land, and could not, therefore, increase rent.

Let us suppose that a tax is levied upon a piece of land because of its value, because, that is, of its superiority over the poorest land in use and in proportion to that superiority, and that the owner of the land tries, because of the tax, to charge more rent to the tenant. In that case the tenant may resort to poorer land on which the rent and, therefore, the tax is insignificant or zero

⁸ Or, more fully stated in the terminology of economics, above the amount which labor and capital could produce on either the extensive or the intensive margin of production.

and leave without rent and with his tax nevertheless to be paid, the too grasping landowner. Such a prospect or its actual realization must cause the owners of land to keep down their rent charges and to pay the tax themselves.

Since a tax on land values—or on land rent, for this comes to the same thing⁹—cannot raise rents, it can in no way raise the prices which tenants charge for the goods they produce or sell on the land. But can it raise the prices charged by the owners of the land for the goods they produce or sell on it when they themselves use their land? Clearly not. Such owners will not, because of the tax, produce any less of the goods in the production of which they are engaged. Refusing to produce the goods would not relieve them of the tax. They will produce as many goods as if there were no tax. And if the tax does not make such goods any scarcer, their price will not be made higher. In other words, if, before the tax is laid, landowners are charging for their goods all they can get, the tax will not cause them to charge any more for they cannot get any more.

If, then, we look at the matter of general land-value taxation from any point of view whatever, we arrive at the same conclusion, viz., that a tax on land value or land rent is paid by the owner of the land and by no one else, that the owner cannot because of such a tax raise either his rent or the prices of his goods, but that, in-

⁹ Although the capital value is itself affected by the tax and falls as the tax rises, while the rental value is relatively independent of the tax. It is therefore simpler to tax economic rent than to tax capitalized value. Indeed, a tax on rent of 100 per cent, would reduce capitalized value to zero.

deed, productive land held out of use by speculators is forced onto the market so that, if land rent changes at all, the direction of the change is likely to be downward. Other taxes may discourage production. But land-value taxation, so far as it has any effect at all on production, operates to increase it and thus to reduce prices or to raise wages or both.

§ 6

Inequality of Earned Incomes

Suppose, however, that it eventually becomes possible to do away with all unfair business practices, to stamp out the industry of the business highwayman, to break up, or regulate, or operate by the public, all monopolies so that justice shall be done to the consumers of monopolized goods, to make birth rates in different classes even enough and educational opportunity general enough so as to avoid the partial monopoly which the relatively few now have of valuable training and skill, and to take by taxation for public purposes the unearned income from land or sites. Would we then have the ideal economic society? There would still be inequality. The man of exceptional genius might still find it possible to secure very great income, and the man who had received large inheritances from his ancestors (assuming the passing of wealth to be substantially unchecked) would have a large income earned, not by his own, but by his parents' and grandparents' saving.¹⁰ It is conceivable that the

¹⁰ It must be admitted that inheritance of property accumulated in a past when exploitation was still possible would not always be inheritance of earned property. It might very plausibly be argued, therefore, that a taxation system adapted to a period of transition

amount of inequality even yet resulting would be dangerous in a democracy. Large incomes, even if fairly earned by the individuals or families enjoying them, might possibly confer the power of corruption and lead to the temptation to use such power for the gaining of unearned income in the future. That the danger would be as great as at present can hardly be credited, and we certainly need not now be prepared definitely to advocate taxation of earned incomes on such grounds. But the believers in democracy will insist that democracy must at all events be protected, and if, by any chance, it should develop that inequality, even of earned incomes, were great enough to threaten democracy, sufficient limitations, by taxation of incomes or inheritances or otherwise, ought probably to be put upon such inequality.

Again, though all incomes be earned, it may be contended that the utility of a unit of money (e. g., a dollar) to the man who possesses many such units is so much less than its utility to the man who earns few as to justify taxing the former more heavily and spending some of the money really earned by the former, for the benefit of the latter. This is the theory on which charitable relief is largely based and it is also the basis of the so-called ability theory of taxation.

Clearly, however, there are dangers in carrying such a policy too far. Those whose ability is high in one line may, to be sure, often be persons of only mediocre ability in other lines of activity; but if the line in which they show ability is one in which ability is scarce relative to the use society has for it, such persons need to be en-

away from unjust economic institutions should contain features which might not be permanently desirable.

couraged to make full use of their ability and it is furthermore desirable that they should have descendants who inherit their capacity for such efficient service. A system of taxing earned incomes which should come too close to leaving individual incomes equal would almost certainly discourage the revealing of ability above the average by those who have it or are capable of developing it, unless invidious distinctions of honor and rank in society were to take the place—if they could do so effectually—of differences in creature comforts.

We need not say that the time can never come when the abler members of a group will put forth their full efforts for the welfare of their weaker social brothers and sisters, who, in turn, will gratefully accept equality of incomes bestowed upon them by those whose productive efficiency is greater than theirs. But it is not to be assumed that this time has yet come, if it ever should or can. Furthermore, it is greatly to be desired that society should breed more largely from its abler than from its inferior members, that those who have high special abilities, provided these abilities are of a useful kind, should be well represented in posterity. It may indeed be true that there is now altogether too much of a tendency for society to breed from inferior strata rather than from the superior. But a change in moral standards and ideals, a growing pride in the ability to pass on worth-while characteristics, may some day change this. Absolute equality of incomes among adults, on the other hand, would negative it, unless those of higher ability were willing to take for themselves and their children fewer and poorer creature comforts than their efforts gave to their inferior brothers and sisters. Again, incomes based on size of families would enable those persons who irres-

possibly have large families, together with their numerous children, to exploit almost without limit those who, by themselves having small families, endeavored to prevent population from outrunning the possibilities of comfortable subsistence. Whether or not, therefore, we might expect the efficient eventually to be willing to put forth their best efforts that the inefficient might fare equally well, it is not even to be desired that the efficient should be willing to put forth their best efforts that the inefficient might have as many or more children and as well cared for as those whose superior ability produced a greater volume of goods.

A parallel argument can be made regarding interest on the accumulation of capital. It is perhaps not even desirable that those who save capital should have to see the interest earned by it go to the support and increase of the children of the incapable and unthrifty. And certainly one cannot but experience grave doubt whether capital would be saved in anything like the present degree if no income whatever were allowed from it either to the accumulator or to his children.

It is to be hoped that no one will draw from the above remarks relative to the competition of individuals within any community and fitness to survive, the conclusion that any selective purpose is secured by allowing the private receipt of what we have called unearned incomes. Superior efficiency in producing worth-while goods is a very different thing, in its relation to societal interests, from superior craftiness in getting something for nothing. A society composed of persons of the former characteristic would have at hand the means for pleasurable existence on the part of all its members. A society composed of

persons of the latter characteristic would be one in which each man's hand was "turned against his neighbor."

If all exploitive activities were terminated and if all unearned incomes derived from advantages of situation, etc., as distinct from unethical business practices, were appropriated by the public, the individual receipt of unearned incomes would be impossible. It would then be necessary to decide whether and how far the taxing of earned incomes for the sake of using the funds to benefit those whose earning power was small, could be regarded as a proper public policy. It is entirely possible that if the receipt of unearned incomes by individuals were henceforth completely prevented, the inequality remaining would not be such as to justify further attempts at leveling. For further attempts in this direction might be thought of as involving the establishment of new privileged interests, the privilege in question being to those who produce least to enjoy equally or more nearly equally than their productive efficiency would seem to justify, with those who produce much.

However this and other problems ought to be settled, it is clear that economic democracy is not to be attained without thought and that it is unlikely to be attained in full all at once. Mobs and reigns of terror will not introduce it. If it be true that the exploited masses cannot trust the teaching of those lawyers, statesmen and others, who constitute the intellectual defenders of things as they are, it is also true that without intelligent leadership in statecraft and an understanding, by their leaders, of economic principles, *an understanding which the socialist leaders certainly have not*, blunders, discredit and eventual rejection will be the probable fate of those who might become the effective forces of reform.

§ 7

Recapitulation

At the beginning of this essay it was pointed out that before economic reform can be profitably discussed, there must be an intelligent comprehension of the existing system of economic organization. For the beneficiaries of the present system have their intellectuals who can give it theoretical justification and they know how, practically, to run it; while its violent overthrow by ignorant revolutionary groups would be almost certain to be attended with mistakes calamitous enough to discredit them and would quite possibly result in the restoration of the temporarily outlawed system of privilege.

Addressing ourselves to the securing of a birds-eye view of the existing economic system, we found it to be one of division of labor with voluntary specialization of individuals and their property in different lines of production. Prices are the inducements by which men are led to sell goods or to produce goods for sale. Compulsion might be substituted but probably would not be popularly approved. Competition tends towards partial equalization of returns in different lines but does not necessarily result in complete equalization. Thus, in any given relation of public demand for two different articles, there may be some persons and some sites as to whom and whose owners it is a matter of indifference whether they should be devoted to producing the one article or the other. But there may also be persons whose efficiencies are such that they secure much larger incomes where they are than they could get in an alternative line or, perhaps, than many persons in such an alternative line do get; and a

parallel statement can be made regarding the use of specific pieces of land and the interests of their owners.

Inequality results, then, so far as returns to labor are concerned, from differences of ability innate or acquired. So far as it results from differences of ability which are innate, it is undesirable that the multiplication of those of less ability should be encouraged at the expense of those of greater ability. So far as inequality of incomes is due to differences of opportunity, these differences are partly a matter of education and partly a matter of comparative birth rates. Low wages in any group are likely to be due to the numbers in that group, competing for employment, and these numbers depend as much on comparative birth rates as on the avenues of escape from the group through education.

In present-day economic society incomes are divided into wages for labor (including profits to self-employed labor), interest on capital and rent on land. Wages of labor are earned or unearned, as the terms are here used, according as they are received for an equivalent service rendered. If, for example, the owners and controllers of an industry derive a monopoly profit because their management has resulted in the building up of a monopoly which exploits the public, much of the so-called profit is unearned. So, also, both the controllers of a business and their hirelings, if engaged in corrupting legislators or in the practice of unfair competition can not be said really to earn what they receive. The same distinction may be made as regards income from capital. Interest is unearned when the capital is used in anti-social and exploitive ways. It is earned when the use of the capital confers an equivalent benefit upon those from whom, in the last analysis, the interest is drawn.

As to land, its rent, resulting from natural advantages or from advantages of situation relative to population centers (pure rent as distinguished from *interest* on improvements), is clearly unearned, and is no less unearned because the owner may have paid some previous recipient the so-called value of the land for the privilege of getting a return from the rest of the community for no service rendered. And the rent of land is unearned whether the land is used in socially desirable ways or not, for, in any case, the owner is in no sense responsible for the existence or the advantages for business, of his land.

Towards the end of the essay we raised the question whether, supposing every kind of unearned income to be terminated or publicly appropriated, it would be desirable for the community to tax large earned incomes (or inheritances) at a high rate for the purpose of preventing, in large part, what inequality might otherwise still remain. For the view that this should be done could be cited a conceivable danger to democracy from inequality even of earned incomes, in case such earned incomes proved to be very unequal, and the theory of charitable relief according to which units of wealth give greatest utility to those whose wealth is small. But, on the other hand, it seemed that efficiency, survival of the best, and accumulation of capital might all be militated against by too great an approach to equality. Indeed, equality of incomes itself, if productive accomplishments are greatly uneven, is a form of privilege in favor of persons who contribute less than they receive.

In any event, we are brought back to the conclusion that the establishment of economic democracy is not a simple task. And it cannot be successfully accomplished unless the great mass of the disinherited who would fain

establish a better system are led by men of greater understanding of economic principles than is possessed by present-day Marxian theorists. Unfortunately, it seems to be these theorists who have attained chief influence and leadership among the supporters of radical economic reforms.

The path of democracy is in truth a way of peril, beset with the pitfalls of a too common ignorance and flanked by the ambushed forces of privilege. Yet only through this pathway can there be any hope at all of the eventual attainment of a better economic order. For although, in a democracy, interested persons and classes are ever seeking to confuse and mislead, in matters of economic policy, a citizenry unduly prone to believe itself championing worthwhile reform when it is really but subjecting itself to a more hopeless exploitation; nevertheless government by any limited class would be almost an absolute guarantee of the self-aggrandizement of that class at the expense of all others. With democracy there is at least the chance that education and the resulting growth of intelligence may lead to better things. We need not—if we are scientists we cannot—have the faith in democracy sometimes professed by the practical politician anxious to flatter the common man into giving him his support and vote, that “the people” will always know and do what the general well-being requires. But we may have a *limited* faith in democracy as the only possible pathway—if any such pathway there be—to an economic system fundamentally expedient and just.

The savage beasts, in Italy, have their particular dens, they have their places of repose and refuge; but the men who bear arms, and expose their lives for the safety of their country, enjoy in the meantime nothing more in it but the air and light; and, having no houses or settlements of their own, are constrained to wander from place to place with their wives and children.

TIBERIUS GRACCHUS

(*Plutarch's Lives.*)

We demand prompt action by Congress to open up for demobilized soldiers, sailors and marines the opportunity to employ their labor on the unused land and natural resources of our country. And we don't want to be confined to swamp lands, cut-over stump lands and desert lands, either. We hold that the hundreds of millions of idle acres of good agricultural, mineral and timber lands and vacant city lots are none too good for the use of the soldiers who are conceded to have saved civilization at \$30 per month, minus large reductions for fines, insurance, etc. . . . Nature's bounty has provided Uncle Sam and all his nephews with ample opportunity for all to work if the government will only let down the bars of monopoly and privilege.

(From a circular issued by THE PRIVATE SOLDIERS AND SAILORS LEGION OF THE UNITED STATES OF AMERICA—quoted in the *New York World*, April 9, 1919.)

II

THE RENT OF LAND AND ITS TAXATION ¹

§ 1

Land Rent as a Marginal Product of Land

In *The Theory of Earned and Unearned Incomes*, the writer had occasion to suppose the existence of a piece of land on which the labor of five men working with the aid of improvements and equipment worth \$5,000, produced a yearly product above repair and depreciation costs, of \$2,200. Of this \$2,200, wages constituted \$1,500, interest (at 8 per cent.) \$400, and \$300 a year remained as rent. This \$300 measures, roughly, the amount of rent the owner could secure from a tenant. It is the surplus produced on the land, above the remuneration of the labor and waiting (i. e., saving, or the postponement of consumption) used. But the remuneration of waiting or saving, the interest on capital, is fixed by demand and supply at a point where it equals the marginal productivity of waiting.² Likewise, the remuneration of labor is fixed by demand and supply at a point where it equals the marginal product of labor.³ Hence, to say that a piece of land yields per year a surplus of \$300 over interest to waiting and wages of labor is to say that it yields a surplus of \$300

¹ This essay is reprinted with considerable changes and additions, from Chapter VI of *The Theory of Earned and Unearned Incomes*.

² *The Theory of Earned and Unearned Incomes*, Chapter IV.

³ *The Theory of Earned and Unearned Incomes*, Chapter V, § 1.

above the marginal product of such waiting and labor. Let us suppose this particular piece of land to be non-existent. Then the labor and capital applied upon it must needs be applied on poorer or less well situated land not previously used, or this labor and capital must be applied to using more intensively land already in use. Applied in either of these ways, such labor and capital would produce \$300 less than could be produced if the labor and capital were applied to the \$2,200 yielding land. In other words, the \$300 is the product of this particular piece of unimproved land *in the sense* that the existence and use of this piece of land makes it possible for a product \$300 larger ⁴ to be secured with no more labor and waiting, simply because the land resources to which the labor and waiting are applied are that much better than the margin at which the labor and waiting in question must otherwise be applied. But although \$300 may thus be regarded as a contribution of the land to production, it is not on that account to be regarded as a contribution of the *landowner* to production.

It is to be emphasized that the rent of city land is determined in just the same way as the rent of land in the country. The well-located merchant derives a larger return from his business as a retailer or a jobber by virtue of his superior situation. So, also, the manufacturer

⁴ By way of qualification it may be said that this differential is not fixed but is greater for some potential users of the land than for others. Some users may be able to gain from the use of a piece of superior land much more than they have to pay. To others, the differential is less than the rent and they will presumably use inferior land. The marginal product of the land is its productivity to the user who is just induced to hire it and who, if rent were greater, would have to resort to poorer land.

whose business is wisely located in relation to sources of power and to shipping facilities derives from such a location advantages for which he may be willing, if necessary, to pay a high rent and for which, if the desired location is equally advantageous to others, he will have to pay such a rent. In the case of either country or city land it is here intended to regard as land rent only the amount which is the marginal product of the land as such. Interest on the cost of improvements, whether swamp draining and fertilizing in the case of farm land or filling and levelling in the case of city land, is not properly a part of the rent of land but is a return on capital investment.

The amount of rent which landowners can get for the use of their land appears to be pretty definitely fixed by the conditions of demand and supply. Attention is commonly called, by economists, to the fact that a tax on land rent can not be shifted. The owner of the land cannot, when a tax is levied, get any more rent. The tax does not increase the marginal product of the land. It does not decrease the marginal product of waiting or the marginal product of labor. It cannot make interest lower or wages lower. It cannot, therefore, increase the difference between the total product of the land and the amount going to capitalists and wage earners. It does not make land any scarcer. The tax-paying landowner can even less afford to keep his land idle than the landowner who is untaxed. It does not decrease the quantity of goods produced on the land and does not increase prices. It simply leaves the landowner with a smaller income by the amount of the tax subtraction. A tax on interest *might* diminish saving and make interest, eventually, higher. A tax on wages, especially if heavy, might di-

minish population and so make wages, in a later generation, larger.⁵ But a tax on rent can have no effect other than to diminish the amount of revenue received by landowners and give this revenue to the general public. It should be said, however, by way of qualification, that when the rent results not chiefly from a favorable situation or other conditions independent of the owner's labor but in part from a fertility which has to be maintained by the owner's efforts, some shifting may take place. (Return on improvements due to labor is properly *interest* on capital.) But a tax upon the *situation* rent or value of land falls upon the owner and upon no one else.

§ 2

Land Rent versus Capital Interest

An examination of the justice of special land-value taxation may advantageously begin with a brief consideration of the difference between rent and interest.⁶ It is sometimes said that the rent of land is no less interest than the return on other capital, since the return on land can be viewed as a given percentage on

⁵ This suggests the Physiocratic doctrine that all taxes must inevitably be borne by the landed proprietors of a country, through diminished population and lower rents. The conclusion may be (and may not be) largely true, if we include owners of urban, etc., as well as agricultural land, as the Physiocrats did not. But a tax on wages thus shifted to landowners will fall upon them in very different proportions than a direct tax levied as a percentage of rental value. The former will fall much more heavily in proportion on the owners of near-marginal land and the latter will fall with equal proportionate weight on the owners of superior land.

⁶ This and the following paragraphs of this section appear also in I, § 5, but are repeated here because of their relation to what is to follow.

a given valuation, while on the other hand, the interest on other capital can be viewed as an absolute amount in dollars per machine or factory, just as land rent is viewed as so many dollars per building lot or per acre a year.⁷ But more fundamentally there is a difference, despite the superficial resemblance, between situation rent and capital interest. The return on land should be looked at as an absolute amount measured and determined by the surplus over production on the extensive or intensive margin. It is not determined by the value of the land. Neither has the value of land as such, i. e., *its situation value apart from improvements*, any relation to any cost of production, since the land was not humanly produced. On the contrary, the value of the land can be arrived at only by discounting its expected future rents or returns at some previously found rate of interest. Thus, a piece of land which would yield \$5,000 per year net rent (above taxes, wages of labor employed, interest on the capital invested in buildings and other improvements, and insurance) would be worth, if interest were 5 per cent., \$100,000. Were the current rate 10 per cent., such a piece of land would be worth but \$50,000.

With equipment of the producible and reproducible kind, however, the relation between capital and income value is not the simple one above outlined. The value of such capital, though not unaffected by the value of its expected services, is very directly related to the cost of its production. Buildings of a type costing \$5,000 each will hardly be put up to sell for much less, as a rule, by the builders. Nor, so long as the alternative is open to

⁷ This view seems to be presented in Fisher, *The Nature of Capital and Income*, New York (Macmillan), 1906, pp. 184-188.

him of supervising the construction of a similar building, will a possible buyer care to pay a great deal more.⁸ The value of a building is determined then, in large part, by the expenses, such as wages, of producing the materials and of putting it up; and these wages are determined, in the last analysis, by the existence of alternative lines of activity open to the wage-earners, while the other costs are determined by the alternative uses to which the *land* or *capital* which must be used in producing the materials might be put.

Since the value of produced and reproducible capital is thus in large part fixed directly by its cost of production, the assertion that interest is in large part determined by the rate of productivity of capital does not involve reasoning in a circle. Interest is 5 per cent. because, for one and perhaps the most important reason, capital worth \$10,000 will produce an annual net income of \$500. It therefore appears, to sum up our conclusions thus far, that the value of produced capital depends in a considerable degree on cost of production, that the ratio between the value of capital and its income is an important factor in determining the general long-run rate of interest, and that this rate of interest is an essential element in the valuation of land.

§ 3

*Land Rent as an Unearned Income*⁹

It is but a short step to the conclusion that the accumulators of produced capital may—and in many cases doubt-

⁸ If he purchases a building already constructed he pays, in its cost, for the supervision of its construction.

⁹ This section is in part repeated from I, § 5, because of the bearing of the repeated paragraphs on the immediately succeeding discussion.

less do—add to the value of the annual aggregate income of society as much as they take out of this income in interest; while the owners of land, as such, contribute no service in return for their income. Whereas, in the case of produced capital, the public (except in certain cases, numerous enough, no doubt, where the capital is wastefully or injuriously used) pays the owner for a service which, without his saving (or the saving of someone whose right to payment has been transferred to him), would not have been enjoyed, in the case of land the payment is made for a benefit which is dependent on no individual's saving or effort and a benefit for which, therefore, no individual is responsible. In the one case the community pays for a service which is actually rendered to it. In the other case it pays people who have, in the capacity in which they are paid, rendered no service.

The view presented so consistently in this book that incomes received not in payment for service rendered lack social justification will not, of course, be accepted by the Junker type of mind. More or less plausible arguments may again be advanced as they have often been before, in favor of incomes to privileged classes. It will be alleged that members of these classes, not having to worry about their livelihood, will become efficient officers of state, scholars devoted to research, and, in other ways, profitable social servants. To the argument that if a class is to be supported without definite regard to a special service for which their income is received, in order that such results may accrue, the public might se-

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lect in a better way the individuals who should make up this class, it will doubtless be replied that, in practice, the public will not select in any such manner as to give equally good results. Or the supporters of a privileged aristocracy may go a step farther and defend its existence, not by virtue of any alleged superior social service, but as being good in itself, as a class for the good of which other classes exist, as constituting "the backbone of the state." To one who accepts either view above outlined, no argument against exploitation will be convincing, especially if the exploitation is of an ancient sort and has the prescriptive sanction of long usage, as is the case with land rent.

To avoid any possible misunderstanding, let it be emphasized that land rent as here defined does not mean merely the sum paid by a tenant to an owner, for the use of land, but equally the amount received by the person who himself uses his own land, in excess of wages for his labor and interest on his capital. This rent comes to him in money when he sells the goods or services which the land produces. He is paid, thus, by others, for benefits which not he but the land renders. The community in buying from him, pays him for more than the service he and his saving render them.

But, it may be said, at least many of the present land-owners are persons who have made their savings from what they have earned and have chosen to invest their savings in land rather than elsewhere. Have they not, in their savings, given the community as much value as they draw in rent? The answer may well be that they have given, to that part of the community from whom their rent income is derived, nothing whatever. If A, who has saved \$10,000, uses it to buy a piece of land

from B, he is merely paying B for the privilege, previously enjoyed by B, of receiving rent from others for the use of something that neither he nor any other individual produced and the use of which would be equally available had no owner or purchaser of land ever been born. In turn, B has now the \$10,000 of accumulations and it is quite possible that he may use it in some way that will increase the annual product of industry. If so, the community, or some members of the community, will come to be paying B, in interest on capital, for services which, without A's saving, would not have been available, while they will be paying A, in rent, for benefits from the use of land, which are not due to any individual's work or savings. If, before, the community was paying the landowner B a rent while getting no service that could fairly be regarded as coming *from him*, now it is making payments to both A and B, as rent and interest respectively, and receiving services in return from only one. If, before, B the landowner was a pensioner to whom the community gave something for nothing, now A has become the pensioner, having bought out B, and is receiving, from the rest of the community, something for nothing. For it should be clearly evident that the \$10,000 paid to B for the land is not a service rendered to C, D, or E, who are the persons that have to pay A for the use of the land. Yet much of emphasis is commonly directed to the assertion that the land-using part of the community ought to pay rent to landowners *because* these landowners have in many cases paid previous landowners for the land and despite the fact that none of the landowners in the series can be said to have rendered any service to those from whom they collect rent payment. In other words, it is asserted that C, D, and

E ought to be obliged to pay A for no service rendered by him or by anyone, simply because A previously paid \$10,000, not to C or D or E, but to B. Is such a doctrine good utilitarianism? Is its application good social policy?

§ 4

Improvements by Special Assessments and the Right of Landowners to a Rental Return

Nevertheless, to assert that in practice the landowner, as such, never performs any service for which he is entitled to a return in payment for the use of his land is going too far. If he is entitled to nothing else, he is usually entitled to a return on the cost, to him, of improvements (such as cutting through and paving streets) met by special assessments. These assessments are customarily made on all owners of land where a street is to be put through or paved, on the theory that they derive a special benefit from the improvement, a theory which is generally in accord with the facts. It would seem that there is much the same reason for the owners of land which is, in effect, improved by such expenditures, to meet them as there is for farmers to pay the cost of fencing and manuring their own land.

That the benefit of this street building (as of social growth) goes to the landowners as such, and not to the owners of buildings on the land, should become apparent when it is realized that a building, apart from its situation, can hardly go much above the cost of putting up another like it. Suppose two building lots side by side, each worth \$2,000. On one, a \$5,000 house is put. The other stands vacant. If the building of a street or the

growth of the community makes the combined house and lot worth \$9,000, is not the added \$2,000 an increase in the value of the land? If there is no change in the cost of putting up such a house, will not the adjoining land (on which an exactly similar house can be built for \$5,000, to sell, with the lot, for \$9,000) immediately come to be worth \$4,000? A house or other building unwisely located where it cannot be used may come to have less value than its cost, by the necessary expense of moving it, or, if it is not movable to a desirable locality, by an indefinite amount. But a house, as such, can hardly increase in value much above its cost of duplication. Analysis seems to show that the increase inheres in the site.

If, then, on the basis of this fact, the owner of land is compelled to bear the cost, or most of the cost, of the improvements made, it seems but reasonable that he should be allowed to enjoy some return on his investment in the expense of paving or other improvement, if any such return is forthcoming. This does not mean that he is entitled to secure all the value that results from social growth, or, perhaps, any of the value so resulting, but it may mean that he should be regarded as the owner of, and is entitled to interest on, the difference between what the value of the land in question would be to a prospective purchaser by whom the costs of improvement had still to be met, and the value to a purchaser after such improvements have been made. In short, the investor is entitled to a return—if the land can ever be made to yield it—on the expense to him of the special assessments.

It seems clear enough to the writer that a not very excessive rate on such expenditures for street-making, etc.,

will compensate owners on the average for any risks that their land may, in certain contingencies of population-shifting, yield less than an average return on such expenses. If, however, a group of lot-owners take steps to have a street cut through long before there is need of it and therefore find that a return on this cost cannot for some time be had, it does not follow that these owners are entitled to get, out of the increased value which later may result from social growth, all the interest lost during the interval of waiting.

That the value of city land usually includes more than can be accounted for by the expense of such improvements is evident if we call to mind the value of well-situated land where such local improvements have not yet been made. A piece of land in a great city, situated where the building of a street was contemplated but not begun, might well be less valuable by only about the cost of the necessary assessments than if the street were there. Without doubt it is sometimes true that improvements such as street construction *start the fashion* of living in a given section of a city and so bring up the value of sites there by far more than the cost of the improvements. But it is also true that the outward pressure of population or the building of a railroad or trolley line gives value to the unimproved land in the absence of streets, and makes the putting through of the streets worth while. In this latter case the causal influence runs the opposite way. It is the conditions leading to increased value, and the contingent possibility of deriving from the land an income previously not obtainable even if improvements had been made, that give rise to the street-cutting movement.

Our conclusion seems to be that owners of land are entitled to a return on their investments in improvements, such as special assessments for cutting streets, in the same sense and to the same degree that they are entitled to a return on the cost of building houses or factories; that, however, they are no more entitled to a socially guaranteed return in the one case than in the other;¹⁰ and that there is no reason why they should be allowed more than enough, on the basis of such expenditures, to make the expenditures worth while. It does not follow that the sums required as special assessments or purposely invested by land speculators in street building, etc., are not fairly subject to tax in the same way as any property is subject to tax, but only that whatever reasons there may be for *special* taxation of land values in general do not apply to the part of land values clearly due to such investments any more than they apply to the part of farm land values due to the owners' expenditures in fertilization.

§ 5

Other Services of City Landowners

Are there any other expenses met or services performed by the city landowner which are to be regarded from the viewpoint of the land-value-taxation philosophy as entitling him to some exemptions? Does the landlord, for instance, perform a service worthy of a share of economic rent by "managing" the land? Is the joint activity of landowners in a given section, in determining

¹⁰ Except as the community compels them to make improvements at their expense in advance of their own desire to do so.

the class or race of tenants who may live in such a section, or attending to other matters of common interest, a service entitling them to the enjoyment of rent? Some of this activity or attention is needed only when the land is used for residential purposes, and perhaps might be given, under some arrangement for a percentage consent in favor of new residents, by tenants instead of by landowners as such, or, as is sometimes the case in a limited degree, by municipal ordinance. The desired protection of tenants in the matter of neighbors is but inadequately given when even two or three landlords, by departing from a general understanding, choose, for a profit, to admit undesirables as tenants or purchasers. Municipal protection might not, in a democratic community, be much better, but it probably would not be much worse. At any rate, any service of this sort yielded by landowners does not entitle them to more than a very small fraction of the annual rent of the land. To say that it is worth all the rent in every case is to say that it is worth much more in a metropolis than in a small town. And to say that all the rent is earned by such service is to say that the cost and trouble of rendering the service so offsets the rent as to make the value of the land (the amount that a purchaser would pay for the future enjoyment of the rent) zero.

Another view is that the rent of land, instead of being, aside from interest on special assessments, altogether an unearned income, is partly a compensation for risk and a stimulus to seek out and bring into use desirable locations. In such a view, it might be argued that the real estate dealers who develop a new section of a city or a city suburb for residential purposes risk getting but an inadequate return; or the capital put into

improvements may be, if the new section proves to be wholly unpopular, entirely lost. Must there be a chance for a corresponding gain of the so-called unearned-increment variety in order that the improvements desired shall be made?¹¹ And if the possibility of surplus gain needs to be kept open to the land speculator, must this gain include all the rental value of the land for all future time? Is the fact that a given speculator foresaw, earlier than others, the possibility of developing certain sites, and thus hastened the flow of business or population to them, a reason why later generations of business people or of residents to whom the early bringing into use of the land is no advantage, should have to pay him for the privilege of working or living on it? Of what service is such earlier development to these later generations, that they should have to pay an extra rent for the space used, in order to compensate for an early risk of loss, landowners or the descendants of landowners who took risk by, possibly, premature building in a new section? So long as this section is now built up and available for business or residence, its having been built long before their use of it is probably of no advantage to present users. If these present users must pay more in consequence of such early development, the landowner is presumably receiving payment from persons to whom neither he nor his predecessors have, as landowners, rendered a corresponding service.

In the case of inventions and patents, we limit the time during which the inventor is to enjoy a special profit on his idea, our philosophy being—partly, at least—that

¹¹ Cf. Hadley, *Economics*, New York (Putman), 1896, pp. 287-291.

after a few years the general progress of knowledge would be likely to bring the essential idea involved to someone else or to several, and that the general public or that part of the public using the invention cannot be regarded as perpetually indebted to the patentee. May not the discovering of, and the calling of the community's attention to, the value of new sites (and likewise of new mines, etc.) be a service of this limited kind? Can it be supposed that the residents of a city would forever, and despite increase of numbers, be indifferent to the advantages of living in "Hillcrest," "Riverview," "Country-side," or "Eastville"? For how many generations must the public pay the descendants of, or the purchasers of land from, those who first emphasized or advertised the advantages of these sections for the service of thus advertising them? It is, indeed, quite possible that the land speculators who first, by their advertising, induced population to move into a new section, have sometimes performed a disservice rather than a service, by unduly hastening a movement which would have normally come somewhat later.

Another point sometimes emphasized in the case of patents is that a limited period of special profit is enough to induce the invention and its exploitation. It is unnecessary, therefore, to make the public pay this excess profit forever. May not the same conclusion apply in the case of the service of landowners in calling attention to the advantages of special sites?

A parallel argument applies in the case of mines, oil wells and power sites. It is unreasonable to suppose either that resources of these sorts would never be discovered except by the individuals who first happen upon them, or that it is necessary, in order to get them discov-

ered and used, to grant the discoverers the entire rental value of them so long as they are used.

Even if we should decide that this particular kind of service was of no value and that we did not wish population or business location to be affected by the activities of land speculators, and even if, therefore, we allowed no part of the rental value of land to go into private hands to pay for such services, there would need to be no fear that houses and other structures would not be built. Obviously, a certain intensity of demand and willingness to pay rent for houses, etc., on the part of tenants, would yield a sufficient average return on the cost of building to make investors willing to take the risk of building in places where there was reasonable probability of the use of the houses, and this without any prospect of realization of situation rent as an offset to possibilities of loss.

While we are on this general topic, one point should be particularly emphasized, viz., that foresight, purely as such, deserves nothing whatever. The man who, foreseeing a rise in certain land values from a probable increase in, or shift of, population, puts himself in a strategic position to profit by it, is not thereby rendering any service to those from whom he derives return. Foresight used to give a service may earn remuneration. Foresight used to get something for nothing seems hardly deserving of any special protection.

§ 6

The Increment of Land Values in Relation to the Settlement of the American West

The expectation of an increase of land values, considered as an inducement to bringing new land into use, has

sometimes been brought up in connection with the settlement of the West. It has been asserted, for example, that the lure of the "unearned increment" was instrumental in inducing the settlement of the West.¹² It has also been argued, in the same connection, that the stimulus to settlement of the West and its earlier settlement because of this prospect of an increasing value of the land, benefited not only the settlers, but also those who remained East, and that, therefore, the unearned increment was "diffused" throughout the country.¹³ Many have doubtless drawn from this contention the conclusion that the descendants of the early settlers in the West are clearly entitled to any increase that may have come to the value of their land, even when cities have grown up on or near it and their descendants have been able to retire and live as landed aristocrats, leaving to others not so fortunate the occupation of agriculture in which their fathers were wont to engage. The argument regarding the diffusion of the increment is based upon the belief that the prospect of rising land values, by inducing a movement of the labor supply westward and its settlement upon the farms, prevented the labor congestion in the East, in the cities, and even in the agricultural West from being as great as it might otherwise have become. Hence, it can be argued, the settlement of the West prevented the (marginal) product of labor from being so small and wages from being so low, in the East and elsewhere, as might otherwise have been the case.

¹² See J. B. Clark, *The Distribution of Wealth*, New York (Macmillan), 1899, pp. 85-87.

¹³ *Ibid.*

But may we not, in some degree, question the conclusion that an unearned increment, or any substantial amount of it, was necessary to get the West settled? After all, relatively few of the settlers were fortunate enough to take up land which afterward became part of the sites of cities and it is probable that most of them did not seriously expect such fortune. May we not conclude that, for the most part, they might have been willing, for the possibility of enjoying homes where the (marginal) product of their labor gave promise of being high to go and take up new land even though the value of the bare land, as such, could not be expected greatly to increase? It is those who, thus, did not greatly profit from rising land values, whose sons and grandsons are now, presumably, working farmers and not landed gentry.

But if, as some economists assert, the prospect of an increasing land value was an essential part of the invitation of the West, then the question arises whether settlement was hastened, to the temporary economic loss of those who went first and to the later loss (through rent payments) of those who followed, and whether a more gradual spreading of population westward, when a real need rather than an artificial inducement began to operate, would not have been economically better.¹⁴

As to the question whether the early comers or their descendants are entitled to rent compensation for being earliest because of any service that they thus rendered, we must bear in mind that any such compensation, under

¹⁴ Cf. Professor H. J. Davenport's article entitled "Theoretical Issues in the Single Tax," in the *American Economic Review*, March, 1917, especially pp. 22-26.

our present land system, does not come from those easterners whose wages are conceivably higher because of the drawing off of surplus population to the West. Nor will it probably come, for the most part, from wage-earners in the West whose wages have been made higher by the movement to the land so stimulated by the prospect of securing a profit from its appreciation. Under the present land system, the rental compensation to wealthy western landowners comes from people living in the West, and mostly from people who came a little too late to get land for themselves, or, in some cases, from people who had other ambitions. It is these people whose coming and whose demand for the use of the land bid up land rents. To them, as persons who have come to be inhabitants of the West, any artificially induced scarcity of labor in the East is no longer—if, perchance, it once was—an advantage. Their wages are not higher, but are perhaps lower, in the long run, than if the West were less completely settled. For the (marginal) product of western labor, if not less, is almost certainly not greater. The old alternative of taking up new and good land is gone. Of course, so long as there was still other new and good land to be had, even western wages must have been kept up by the rush of labor to this land, but this would not continue to be the case as the land filled up and as the available free land became progressively poorer.¹⁵

In what sense, then, and how far, were the benefits of rising land values diffused? Was it in such a sense that

¹⁵ Furthermore, the consequent inflow of new labor from the East and of immigrant labor into both East and West tended, by rapidly filling any vacuum, to prevent any considerable realization of such a gain in wages.

the descendants of those who did not take up land must, in justice, pay the descendants of those who did, for the privilege of living and working on it? Are the descendants of those who did not acquire the land to be regarded as having so gained from the possibly slightly larger labor incomes of their grandfathers, or to have so lent their moral sanction to the system, as to be under obligation not to change it, even where cities have grown up and have made land which was worth its hundreds of dollars now worth millions? Is it their social duty to go on paying indefinitely for the use of land which would be equally available and which would be about equally desirable if any individual owner to whom or to whose descendants the payments for its use are made had never lived? Or can society in general be regarded as having ever even impliedly pledged itself that the increase in land values resulting from social growth should go entirely to individuals and should not be subject to any considerable taxation by states or cities?

Is it not, indeed, clear that we are very definitely maintaining a land system which makes part of the public pay large sums annually to the rest of the public for no service that the recipients of these sums, or their ancestors, or any other landowners as such have ever rendered to the persons from whom their rental incomes are derived? Why are those who thus pay without getting, under an obligation to maintain the system and to continue paying through all future time? Must countless generations of the disinherited be held under obligation to pay for a somewhat problematical "diffusion" benefiting some of their ancestors, a diffusion from which

most of the descendants of those who may thus have somewhat benefited have very likely realized nothing whatever? We do not allow the creditors of a father to require payment for the father's debts from the labor income of a son, however much the father may have gained—in his lifetime—by his borrowing, nor do we insist on “compensation” to a creditor who is therefore unable to recover. We adhere to this policy because we do not consider it socially desirable to make one class partially the slaves of another class, to compel them to spend part of their time working for that other class without return from the latter, even though the latter class may conceivably have rendered a real service to the ancestors of the class that pays. May it not be as much contrary to good public policy to recognize any implied contract by which, as an offset to the possibly temporarily larger incomes of one class, the descendants of that class have to pay others for the use of the earth? Is not the recognition of any such implied contract equivalent to recognizing the right of men to sell their children or their grandchildren into slavery? We would not recognize the latter right, in our society, directly and avowedly, even if the children were sold to get food to save their lives. Must we recognize the former? It is true that, in the case of land rent, we *associate* the payment made with a material thing, the land, but are we not, nevertheless, in essence, dealing with a payment for which no service is rendered?

If it is said that the western homesteaders sometimes had to fight the Indians, it can also be said that they frequently and largely received protection from the United States army paid for out of the general tax fund; and it may well be that men who served in the army and

gave such protection, or men who contributed in taxes to maintain it, afterward came to have to pay, for the use of land, persons so protected. It is to be questioned whether any service of the pioneers, still less of the droves of later settlers, who followed them while the land was still cheap, was so important and far-reaching that the descendants of the more fortunate ones can be held to have acquired a right to receive tribute for all future time because of this service, and that the millions of dollars of situation rent in the cities of Chicago, St. Louis, Denver, Los Angeles, and San Francisco really all represent legitimate payment from later comers and their descendants for the *equivalent* services to these later comers and their descendants, of those who chose to come first. Surely, one who holds this needs take but a short step farther to prove that the whole idea of the unearned increment is a myth, or the product of diseased imagination, and that, really, anything that anyone gets is earned by equivalent service to the one who pays it.

A qualification of society's right to land rent should be made in the case of a country the population of which has increased or is increasing beyond the point of maximum per capita production. In such a country there may be many families who have each enough land for the most efficient application of their own labor and for comfortable subsistence and who, by limitation of offspring, are preventing the undue subdivision of such land into small plots—who are doing their share in keeping up the general level of comfort by trying to prevent too great an increase of population in relation to available land. If the rest of the nation multiplies quite without regard to natural resources or land space and so forces down the wages of labor production, society's right to

land space will scarcely justify re-dividing the land equally, thus directly depriving the families which have kept down their numbers of the standard of comfort which would naturally result from their low birth-rate. Nor will this right of society justify a system of taxation of rental values which indirectly accomplishes the same result. For it should be clear that if the land so held by individual families comes to be more valuable, not by virtue of its yielding more, but solely because pressure of population increases the demand for it, then to take all of the greater annual value in taxation may leave less to the owners than they could previously fairly earn. To express differently the same thought: if the policy of state appropriation of land rent is consistently applied, so that individuals get only the earnings of their other capital and the wages of their labor (employed or self-directed), then an increase of population which lowers the productiveness of labor will not only enable the state to collect more than previously from individual landowners, but will leave less to them as individuals and families than before. Such an increase of population will then leave less than before even to those families which are in no way responsible for the population increase from which flows their new family poverty. For this reason,—viz., because it would remove a stimulus to desirable limitation of offspring, because it would penalize the far-seeing, because it would give to families whose ideals tend toward universal misery the inheritance of those families whose self-imposed limitation of numbers certainly does not decrease the amount of land available for the rest of society and whose ideals, if generally adhered to, would bring universal plenty—such an appropriation of all rental values of land might not be a desirable social

policy. Part of the rental value of land, even of agricultural land held by actual cultivators, may fairly be taken, but not, in crowded countries, all.

However, in practice the increase of land values is usually in large part an increase in the value of special sections of land which growth of population causes to become more advantageously situated in one or more ways. As the country grows, certain places come to have new and special advantages as market centers, as ports, etc., and thus acquire an increased rental value not dependent on a lowering of the margin of production. Increase of population in a fertile, unsettled plain, containing a great deal of land of approximately the same fertility, might not for many years lower the marginal product of labor. To be sure the later settlers might have to go farther, but the more distant points would be no more isolated than the first-taken land was at an earlier date, and the extension of roads and railroads might make them less so. Rent would rise, not because the margin has become lower, but because the situation of a part of the land relatively to markets, population centers, etc., has become better. Still more clearly does this fact stand out when at some point on the plain a city develops, called into existence by the increasing number of those whom its merchants, artisans, *et al.*, can effectively serve. Its growth is, possibly, an advantage even to the owners of marginal land, but confers a special advantage on those whose near-by location enables them to reap exceptional profit from supplying the city needs as to produce. The growth of the city confers a still greater advantage on those whose land comes to have value for distinctly urban uses. The occasional settler who or whose descendant finds that his land is in

the center of a thriving city may become a millionaire as a consequence of conditions to which his own contribution was negligible if anything at all. In this case and, in general, in a country like the United States, land rent has probably grown much more largely by the increase of the possibilities of special, often supra-marginal, land, thus creating a differential between it and marginal land, than by forcing cultivation to a lower margin. Hence, any desire that we may feel to protect small landholders who limit their families from being made to suffer through the general increase of population, need not prevent us from taking, in taxation, most of the rental value of land, including that of mines and power sites, and nearly all of the rental value flowing from its situation of city land.

§ 7

*The Bearing of the Contention that there may be Other
Unearned Incomes Not Especially Associated
with Land*

It has sometimes been pointed out, by way of objection to the single-tax proposal, that land rent is not the only income which is of the nature of an unearned differential. Sometimes the incomes of genius in excess of what persons of ordinary ability can secure are presented as an analogous case. Whatever may be, in some respects, the degree of likeness, the two cases certainly are not alike in all respects. Thus, it may not be equally possible to tax largely and successfully the incomes resulting from the exercise of genius, as to tax land rent, for, in the case of the large incomes of the exceptionally gifted, the attempt to tax them heavily might conceivably discourage

effort and cause the former recipients of these incomes to be satisfied with smaller—and, therefore, untaxed—returns. Taxation of the rental value of land, however, if based upon such general considerations as the evident yield of neighboring sites and the apparent market value of the land to be taxed, i. e., if the tax is not made larger because an efficient producer or business man gets more from his land than others could get, would probably in no wise affect the owner's choice of uses for the land or his intensity of use of it or the efficiency of his use of it. Having a tax to pay which was independent of his efficiency, he would be just as eager to earn the maximum income out of which to pay the tax as he would be to earn the maximum income if he were not taxed.

Indeed, the levying of a tax upon the *potential* situation rent of land, whether actually received or not, would discourage the speculative holding of land out of use and so would operate to prevent the forcing up of rent by any scarcity of available land induced by such speculative holding.

Economists whose class sympathy (of the influence of which they are not always conscious) or whose training by their former teachers, incapacitates them for seeing any distinction between land and capital and predisposes them to accept superficial resemblances as a conclusive defense, are fond of saying that other values than land values are enhanced by social forces. It is true enough that dress suits are likely to have less salable value in the Ozark Mountains than in the centers of wealth and fashion and that a twenty-story office building is worth more in New York City than in a country village. Nevertheless, cases of monopoly excepted, it can hardly be denied that, year in and year out, produced goods cannot be

sold anywhere for much more or much less than the cost of producing them in the places where they are to be sold. An occasional dress suit may have to be sold at a sacrifice in the Ozarks, and a building too large for the needs to be met may prove to have been a mistaken investment in the country village. But as a general rule dress suits will not be produced in or transported to the Ozarks except as the anticipated price covers costs, nor will skyscrapers be regularly built to sell for less than a return which seems reasonable in relation to building expenses. And, on the other hand, where competition is active and is carried on fairly, the prices of goods which have to be humanly produced cannot go much above costs. Even making all possible qualifications for cases of obsolescence and for changing conditions of production, can anyone say that cost is really an element of corresponding significance in the case of land rent?

Again, it may be said that there is possible no large remuneration, in a sparsely settled primitive community, for the person gifted with an exceptional voice or other highly specialized talent. But neither is so large a *service* possible in return for the remuneration. When such remuneration is received it is in return for an equivalent service rendered by the person who receives it, and this is not the case with the situation rent of land. May not considerations of eugenics as well as of efficiency in service, apply differently to the proposition to tax such incomes than to the proposition to tax land rent?

Furthermore, some of the incomes which are often thought of as unearned are chance gains so offset by corresponding deficiencies of incomes at other times, as to mean no average loss to the public. If the failure of the Argentine wheat crop may unexpectedly give to Ameri-

can farmers, grain dealers and millers a higher return than was contemplated when they made their expenditures for seed, labor or grain; so, also, an unexpectedly large crop of wheat in Argentina, Canada, or elsewhere, may compel the same persons to accept prices which fall far short of compensating them for the expenditures and effort undergone. The general public is likely to gain in the latter case as much as it loses in the former. But the general public never gains from an unexpected fall in the rental value of land except in the sense that the public is then *less exploited* than before. It continues to be exploited, though in a smaller degree. There is little point to an attempt at equating continuous exploitation varying in degree, with occasional excess pay for service which is likely at other times to be underpaid.

It will be worth while, here, to emphasize the fact that land rent involves exploitation when the land is used in socially desirable ways as well as when it is used anti-socially. In the latter case, payment is made for a disservice. But even in the former case payment is made for a zero service or for a service less than equivalent to the rent. Where wages of labor, interest on capital or rent on land are secured by activities or by uses of property which definitely injure the general well-being, which are anti-social, *these activities or uses should be prohibited* rather than that men should be allowed thus to secure wealth which society afterwards taxes. When a business concern by means of unfair competition, e. g., by misrepresentation of competitors' goods or by securing discriminating rates on the railroads,¹⁶ succeeds in get-

¹⁶ See, for a fuller discussion along this line, the author's *Principles of Commerce*, New York (Macmillan), 1916, Part III, Chapter VII, § 4.

ting extra profits which its rivals do not get, or, being able to undersell the rivals discriminated against, gets business which would otherwise go to them, we have a clear case of unearned income resulting from anti-social activity. Success is made to depend, not on superior service, not on superior efficiency in economizing labor, but on the ability to exclude rivals from the market even if, as may well happen, these rivals are much more efficient in the proper business of both or all. The public cannot afford to let the principle become established that success and wealth may be gained by such methods. In the long run, consumers must expect to suffer unless competition of this sort is effectively forbidden. So, too, in the case of monopoly, which gives more than an ordinary return to effort or to the users of capital or land, it is the consumers of the monopolized article or articles who are entitled to relief since it is they alone who are exploited.¹⁷ In general, industrial free-booting should

¹⁷ No opinion is here expressed regarding the relative desirability, from the viewpoint of preventing high monopoly prices to consumers, of public regulation and of public operation of industries which have to be or ought to be of monopoly size. But if public operation is chosen, it would seem, on the principles set forth in this book, undesirable that the public should pay for the capitalized value of the land rent included in the prospective returns of such monopolies. If not to pay for such capitalized exploitation in cases where the public chooses to take over the ownership of any industries is objectionable as discriminating against some landowners while allowing others to continue to enjoy site rent, then the taking over of these industries by purchase should be deferred until a general policy is adopted towards all site rent. Nor should government for any long period guarantee interest or net dividends on the bonds or stocks of companies whose property it undertakes to operate. For suppose that during the period of such a guarantee, one

be stamped out, so far as this is possible. *But for unearned income in the form of land rent, purely as such, the tax method is adequate and is the logical method of correction.*

Again, even if there are—as there may be—other increments than situation rent which are equally unearned, it does not follow that the heavier taxation of land values should be deferred until such time as a general agreement is reached regarding such other increments. It may suit the views of reactionaries to have us use the claim that many and complicated reforms are needed, as a reason for delaying one the justice and desirability of which are reasonably evident, but that kind of attitude should scarcely suit anybody else.

§ 8

The Taxation of Future Increments of Value

Hesitating to accept the more radical proposal of Henry George in favor of sweeping into the public treasuries situation rent both new and old, some writers have

or several of the States, or the Federal government itself, should choose to adopt a new tax system, e. g., to increase very greatly the tax on site values. This would for all other industries than the ones in question diminish the land rent part of their incomes, though to be sure, removal of other taxes might increase other elements in their incomes. But, whatever the net result on these other industries, the holders of the securities of the government-operated industries would experience no effect as regards their annual returns. The better way would be to guarantee (if there is to be a guarantee of past earnings), net earnings from business but not net earnings after the subtraction of taxes.

contented themselves with advocating the public taxation and use of *future increases* in the rental value of land.¹⁸ This advocacy, they seem to have felt, frees them from the necessity of urging anything that looks like confiscation. But there are reasons for thinking that if the more radical proposal involves confiscation, the other does also, though it may be less in degree; and it is doubtful if the more moderate plan can be successfully defended without raising a presumption that the more far-reaching scheme has also something in its favor.

To the proposal that only future increases in rental value be taken by the state, it has been answered that to take future increases without compensating landowners in the case of future decreases in the value of their land unfairly deprives them of the chance of gain while still leaving them the risk of loss. In the words of F. A. Walker, "the game of 'heads I win, tails you lose' is not one in which the state can, in fairness and decency, play a part."¹⁹ If one believes that the *present* rental yield of land, as well as future increases of this yield, should not go to the private owner, this contention will not disturb him. Otherwise it may seem to be convincing.

There still remains the argument, however, that, in a growing country, increases are frequent and decreases rare and that, therefore, no large injustice would be done by the scheme. But what if the opposition contends, as it plausibly may, that the present owners of land have, in

¹⁸ See, for example, Taussig, *Principles of Economics*, New York (Macmillan), 1912, Vol. II, p. 102. This scheme was suggested by John Stuart Mill in the middle of the last century.

¹⁹ *Political Economy, Advanced Course*, New York (Holt), 1887, pp. 416-17.

many cases, bought it at prices which they were willing to pay only because of the prospect of future increases? The opposition may contend, in other words, that expected future yields have been discounted into the present price of the land, and that, therefore, to tax heavily these future yields will deprive such purchasers of an income they paid to receive, and will depreciate the value of their land below the price at which they bought it. Some increases, to be sure, may come as unforeseen luck, but many must be, at least in part, anticipated. Is a tax on such increases any less "confiscation," so far as the capitalized value of land is concerned, than would be a moderate increase in tax which would take away a part of the constant annual rent of a piece of land bought with no expectation of a rise, but bought in the belief that its owner would be left undisturbed in the enjoyment of the entire rent?

Without now pursuing this comparison further, we may note that a doctrine according to which the public has no right to take by taxation future increases in land values, increases not earned by any service rendered by the landowners, must, logically, be opposed to other governmental policies of which most of us are in favor. Such a doctrine would mean, for instance, that the purchaser of stock in a company which contemplated—or the purchaser of whose stock foresaw the likelihood of its undertaking—selling out to, or becoming part of, a monopoly and so securing monopoly profits, since such purchaser paid more for his stock because of this expectation, must be allowed to enjoy these monopoly profits, or, if they are taken away from him, must be *compensated*. Has the purchaser of stock under circumstances of this kind any such claim even if the policy of limiting

monopoly profits is one which was not previously in force but was adopted after he purchased the stock?

§ 9

Land-Value Taxation in Relation to the Theory of Vested Rights

The principal objection actually felt, if not the one chiefly emphasized by opponents of land-value taxation, is an objection based upon respect for vested rights, viz., that such a scheme of taxation would take away from the owners of land a large part of the capitalized value of their property by making it impossible for them to enjoy from it the expected future income. If a piece of land yielding \$1,000 per year is valued on a 5 per cent. basis, its selling price would be \$20,000. To take \$200 a year would mean, since a tax on land rent cannot be shifted, that the selling price of the land must fall to \$16,000. Hence, it is said, since such taxation takes from the owner a fifth of the value of his property, it is confiscation and a denial of vested rights. Of course what we definitely take is a fifth of the yearly income, but since the value is dependent upon the income the establishment of such a tax as a *permanent part of the tax system* in effect takes one-fifth of the capital. But how is it if through indirect taxation we take \$100 a year from the family of a workingman whose annual income is \$500? If the man's expectation of life is thirty years, would not the capitalized value of his income be well in the thousands of dollars, supposing it to be salable? And would not this capitalized value be reduced one-fifth by a tax of \$100 per year if such a tax were adopted as a permanent part of the tax system? To be sure, workmen are

not in the habit of thus capitalizing and selling the right to their future incomes, but is the injury to them from a tax any the less for that, or the fundamental nature of the problem essentially different? If a need of increased revenues were thus met, there might be sympathy expressed for the working classes and objection to the tax as an undue hardship upon them, but the word "confiscation" or the expression "vested rights" probably would not be used. No complaint would be made that the fundamental rights of property were being invaded or that society had violated any implied pledge.

It seems to be this last notion, that of an implied pledge or sanction given by society, which makes many thinkers regard so askance any proposal for radical changes. We must not take rent in taxation because the enjoyment of it is a vested right. "Society" has allowed individuals to appropriate nearly all of rent in the past and various persons have bought land, relying upon the continuance of the system. Hence the private enjoyment of land rent must always be allowed unless compensation is paid by the dispossessed to the possessors.

If we are perfectly frank in our adoption of this vested-rights argument as a reason for refusing to take from those enjoying them incomes not earned by service given to those who pay them, we shall have to admit very frankly that several types of incomes ordinarily objected to by economists must be continued indefinitely. Thus, in consistency, we must protest against any regulation of monopoly which will do away with the monopoly prices on which any monopolists had counted, and particularly so if the monopolists have bought stock at a higher price because of the expectation of monopoly profit. "So-

ciety" has permitted this profit in the past, has lent its "sanction" to it, has allowed people to buy stock in the expectation of realizing an exceptional profit. May society, therefore, by its regulations cut down this profit? Must it not pay the monopoly prices indefinitely or else *compensate* the monopolists by paying them in advance the capitalized value of their expected future monopoly profits?

So, again, if we would be perfectly consistent, we must not remove the protective tariff on goods when those who have invested in the companies producing such goods have paid more for their stock than they would otherwise, in the expectation of deriving protected profits. In other words, since, largely through the influence of those engaged in protected industries, the policy of protection has been maintained for a limited number of years, society at large owes such industries a continuance of favor. In still other words—for this is the inescapable implication—those who wish to consume the protected goods may properly be required to pay for these goods an excess price, a price above the real value of the service given. In this view of the case, the taxed class, being part of society, has some sort of responsibility for what society has done, even for what the class that profits by protection has influenced society to do, and has no right suddenly to refuse longer to pay tribute to the protected class.

The foregoing is a view which the writer cannot bring himself to accept. Society is under no obligation nor is any class in society under an obligation to pay tribute to any person or group of persons for all future time. Still less is a class which, *while another class has controlled government*, has been exploited, under obligation

to continue to let itself be exploited if and when it is able to get into the saddle. Society as such has given no pledge, and is not in a position to give a pledge, that its policy will not change. Those who buy stock in a monopoly or invest their money in a protected industry must be held to have done so, not under any guaranty of permanence, but at their own risk, knowing it to be the right of the rest of society to cease paying the excess prices and adopt a new policy at any time.

How does the matter stand in the case of land values? Must not purchasers of land be presumed to have purchased in the knowledge that rates of taxation might be changed and that government might discriminate, for purposes of taxation, among different kinds of property as it often has done among different commodities? Is it correct to think of land-value taxation primarily as a system of taxation that infringes on vested rights by taking something away from landowners? Is it not more enlightening to call to mind that, indeed, the rest of society is continually (weekly, monthly, or annually)²⁰ paying tribute to the owners of land, tribute for which neither these owners nor any previous owners as such have ever rendered a return to those who thus pay them? When we say that for the public to take in taxation most of the rental value of land would be to confiscate the "property" of those who had previously enjoyed this rent, do we not express the fact the wrong way about? Would it not be nearer the truth to say that the rest of society simply refuses longer to have its earnings con-

²⁰ Cf. Henry George, *Progress and Poverty*, Book VII, Chapter III, particularly pp. 362 and 363. (Page reference is to edition of 1905, Doubleday, Page & Co.)

fiscated by the landowning class? Does the situation value of land, the value apart from improvements, represent anything else but the estimate, in a present valuation, of the future tribute, the future payments without corresponding services, which the owners are in a position to get from others? Are not the masses paying a perpetual tax to the owners of land for the privilege of living upon, and making use of, sites which were neither produced nor rendered valuable by the owners? Suppose the masses who are thus paying tribute without receiving either labor services or more capital equipment for production than would otherwise be available, or indeed anything else worth the price, simply decide to stop paying this tribute! Would their doing this be confiscatory? And must they, if they are to cease paying, compensate the landowners by giving to the latter interest-bearing bonds worth as much as the land, and payable finally, as to interest and principal, by the same persons who now pay rent? Is this not equivalent to saying, not only that those who are slaves in the sense that they devote much of their labor to the support of a parasitic class cannot be freed without provision for compensating the parasitic class, but also that the compensation must be provided by the slaves? Could we reasonably expect the slaves, once they were in the saddle politically and thoroughly understood the matter, to take this view of it?

As an analogy to the payment of tribute for the use of land to persons who are in no way responsible for its existence, let us suppose that an ancient king or a small ruling caste has somewhere given to a favorite or to someone of political influence the negotiable privilege of collecting each year a certain amount of the taxes

and turning them to his own use. The favorite later sells his "right" to another for a large sum of money which that other had honestly earned by hard and faithful work at a useful task. Some time after this second arrangement is made, the taxed class overthrows the power of the king or aristocracy and establishes itself in power. Must this class go on contributing the tax because the would-be recipient paid to get it, notwithstanding he paid nothing to those whom he now expects to pay him? And if they refuse, using the money in question instead as part of their general tax fund for common purposes, are they guilty of an immoral act? Must not the would-be collector of tax money be assumed to have made his purchase subject to the condition that society could in its own good time make such changes as its members might see fit? And if the remainder of society came to believe that, in the long run, *the greatest good to the greatest number* would be attained by establishing a system in which, in general, each should profit according as he served, and in which, *except as some special social reason justified the apparent exception*, no one might receive tribute from those he did not serve, would not society have a moral right to establish such a system?

The truth is that few of those who advocate large taxation of land values, even of the single-taxers, urge any but a gradual change in the rate of taxation of land. A sudden break with the past is not sought for. Nor, if it were, would there be any serious likelihood of its coming. Though we may work for the change with ardor, it will probably come through compromises and little by little. But even if the tax change, as such, were suddenly made, its being preceded by a long period of agitation and of growth of the land rent taxation senti-

ment would forewarn landowners and operate to ease the transition for those who were likely to lose by it. Indeed, it is not unlikely that by the time such a change goes into effect—if it finally does go into effect—many landowners will have come into possession of their land more or less expecting the change and will have allowed for it in the price offered for the land they have purchased.

Again, even if, here and there, a town or city increases rapidly the amount of tax it puts upon land, this may not, while the new system is not general, cause very considerable loss to landlords. For it will be likely to mean that in those cities business and individuals are relieved of other taxation which elsewhere they have to meet, and the policy will, therefore, probably cause those towns to be more rapidly settled (by the drawing of population away from other towns) and land rents in them to go up.²¹ This is a result which would not be brought about if the equally rapid increase of land-value taxation in other places kept the balance.²²

Furthermore, even if the tax were generally applied, no great loss would fall on small landowners who have improved their land and who themselves live on it, persons

²¹ Suggested by Professor H. J. Davenport's *Exercises*, printed to be used with his *Economics of Enterprise*. Cf. pp. 28 and 29 of Professor Davenport's article in the *American Economic Review*, March, 1917.

²² Some may regard it as an objection to a purely *local* application of anything approaching the single tax and the local use of the funds derived from it, that such a policy gives to labor in the town adopting it a benefit more than it receives elsewhere and therefore induces labor to come to such a city when otherwise it would stay away, and, by inducing surplus labor to come, brings diminution of the product of this particular labor.

who own their own homes and little else,²³ and many such would clearly gain. But to persons owning land and buildings which are used by others or for the production of goods to be sold to others, a tax on land rent might eventually involve a considerably heavier burden, since such a tax clearly cannot be shifted (if general), while the tax on buildings very possibly can be, at least to some extent.²⁴

The removal of taxation from all capital and its concentration on land values would of course involve an increased burden to those whose property was chiefly in land values. But the immediate loss to the person who owned both land and capital would be minimized by the fact that he would be enjoying relief from taxation on his capital²⁵ (the interest from which, if the capital was itself earned and was being used in socially advantageous ways, would be earned), at the same time that he was being made to pay heavier taxes on his land (the situation rent of which was principally unearned). In the end, the removal of taxation on capital would presumably reduce interest rates if the leaving of larger net returns to owners of capital operated to encourage capital accumulation. But for some time the average property

²³ Cf. Henry George, *Progress and Poverty*, Book IX, Chapter III.

²⁴ Whether a tax on all the earnings of capital regardless of the line of investment could be shifted and to what extent, would depend on whether and how far such a tax diminished saving. See the discussion of the effect of interest on saving, in *The Theory of Earned and Unearned Incomes*, Chapter III, § 5 (last three paragraphs of section).

²⁵ If the shift in taxation from capital to land were great and sudden, therefore, the *rate* of interest would be temporarily higher and whatever was left to landowners of site rent would have to be capitalized, for a while, at this higher rate.

owner would probably be largely compensated in his greater net interest on capital, for the reduction by taxation of his net rent on land.

In truth, when all is said regarding confiscation, we must recall that government cannot possibly raise revenue without taking something from somebody. And if we have to choose between taking an unearned income already being collected by part of us from the rest of us, or allowing part of us to enjoy such an unearned income and taking something more, in taxes for common purposes, from the rest of us, the choice should not be difficult.

To be relieved of the burden of supporting social parasites by rent payments while at the same time supporting government out of taxes, and instead to let the rent serve also as the taxes, would mean a clear and large net gain to the classes previously exploited. Yet many of the exploited, understanding little what is happening, and failing to distinguish between property incomes based on service and property incomes purely exploitive, prate pseudo-learnedly of surplus value, the class struggle, and the prospective evolution from capitalism to socialism. Eternal children in their comprehension of the working of economic forces, unwilling, for the most part, carefully to examine any other economic philosophy than their own, the majority of socialists are ready to follow the Marxian doctrines wherever they may lead, as the dancing feet of the care-free children of Hamelin followed into the dark mountain-side the enrapturing music of the Pied Piper. The socialistic theory in outline is simple. To the mind unused to analysis it seems to be both a comprehensive and a conclusive account of the nature of exploitation. But its doctrine re-

garding the nature of interest on capital is utterly fallacious²⁶ and the prospect that its program could be put into effect and made to work is exceedingly dubious.²⁷ The classes which profit by privilege, are, in their understanding of economic and social phenomena, but little superior to the exploited masses. Were this not the case, and were there not the fear of Bolshevik violence, we might well expect them to be exultant at the relative strength of socialism among reform movements. For socialism almost hopelessly diverts the minds of those who might be the principal protestants against the receipt of unearned incomes into an indiscriminate opposition to earned and unearned incomes alike. And it therefore serves to prevent recognition of facts the recognition of which by the masses might mean to those who hold economic power based on privilege rather than service, real danger of its loss. The one chief virtue which socialism, as currently preached, does have, is its insistence that evils exist, that present conditions are far from ideal and that the doctrines and propaganda of the privileged classes are not to be accepted as final truth.

§ 10

The Ability Theory of Taxation

Nor should we be turned back from the taxation of land rent by the contention that the proposal so to raise much or most of the public revenues, does not conform to the ability theory of taxation. It has never been finally

²⁶ See *The Theory of Earned and Unearned Incomes*, Ch. III, § 5 and Ch. IV, § 10.

²⁷ See the preceding essay (I), § 2.

established that taxation ought to be in proportion to ability. Taxation ought to be arranged with a view to societal welfare, and this may or may not mean that it should be in proportion to ability. Societal welfare may be better furthered, for instance, by preventing exploitation and the consequent receipt of unearned income, than by mathematical precision in apportioning taxes to total income of all sorts. The ability theory of taxation rests upon much the same ground as the theory of charitable relief. In the case of charitable relief it is argued that the sums thus expended have a greater (marginal) utility to the poor and helpless who receive them than to the relatively prosperous who contribute them (voluntarily or otherwise). In the case of taxation it is argued that a large requisition from one who is prosperous may involve less deprivation and sacrifice than a small requisition from one who is comparatively poor, or, otherwise expressing the same idea, that to take money from the well-to-do, even though they have fairly earned it by giving equivalent service, and to expend it for public purposes so that a large part of the benefits from its expenditure is received by the relatively poor, will increase utility and will increase the sum total of happiness. Assuming wants to be equal, one might with some plausibility argue that the maximum of aggregate human happiness could only be attained by carrying this principle to the point of equalization of incomes. But long before incomes had been equalized the effects on efficiency of labor, perhaps, also, on the rate of accumulation, and, possibly, on biological selection, resulting from neglect of the principle of making incomes received depend on services rendered, would become serious. The greatest welfare would *not* be thus secured, *in the long run*. If,

therefore, we venture to make some partial application, in our tax system, of the principle of equalizing incomes, we must *sharply limit our application of this principle* in the taxation of earned incomes lest we depart too far from the principle of *proportioning incomes received to services rendered*. But whether or not there are classes which, because of their poverty, ought to receive from the community in personal incomes and in services from government, more than they contribute, in taxes and otherwise, to the community, it seems quite certain that the recipients of situation rent, as a whole, do not constitute such a class. And whatever justification there may be, from the point of view of maximizing utility, in providing that the poor should exploit the rich, it is doubtful whether there is any equally plausible justification for provisions which enable the rich to exploit the poor.²⁸ This, it is believed, is mainly the direction which is taken by the exploitation growing out of our present land system. If, then, among the owners of land who profit by the exploitation, which is inextricably bound up with the present system, are to be found the ubiquitous "widows and orphans" whose anticipated distressful state has been made the basis of opposition to many other necessary reforms, it is better that society should make special provision for them in those exceptional cases (assuming that there are any such) where the shifting of the tax burden from other values to site values threatens them with poverty, than that it should forever maintain a bad

²⁸ The writer is not unaware that such exploitation has been suggested as a means by which savings may be made which the poor, having many unsatisfied needs, would not make. See an article by Alvin S. Johnson, in the *Political Science Quarterly*, XXIII, pp. 221-241 on "Protection and the Formation of Capital."

system. Indeed there must be many widows and orphans who are victims of this system, of which some of their class may be beneficiaries.

§ 11

The Taxation of "Excess Profits" versus The Taxation of Land Rent

In view of the contemporary popularity of taxes on so-called excess profits, the question ought to be raised whether such profits can advantageously be taxed, year in and year out, on the same basis as site rent. These excess profits, when they are not the fair earnings of superior efficiency in serving the public, must be either the returns of monopoly or the gifts of chance. If they are the returns of monopoly it is, indeed, better to tax them than to allow them to be privately enjoyed, but it is better still to protect the consumers of the monopolized goods against extortion. If the excess profits are the gifts of chance they must be considered along with chance losses, and when so considered will be seen not to be analogous to land rent. For, as was stated in a previous section,²⁹ it is incorrect to equate continuous exploitation varying only in degree (rent of land) with occasional in-excess-of-average pay for services which, on other occasions, may receive less than average remuneration.

But there is another important reason for discriminating between excess profits, so-called, and land rent. Large returns in any line of business which is relatively unable to meet the demands upon it for goods or services are

²⁹§ 7.

the means by which, in the competitive system, men and capital are induced to go into such a business. The goods and services produced by the business are temporarily worth more than ordinarily to the community because they are relatively scarce. But the larger returns therefore received by those in the business in question bring their own correction just because they operate to draw men and capital into the desired line of production and so increase competition.³⁰ Not only is it true, then, that the excess returns tend to be only temporary, but it is also true that to tax them largely out of existence might operate to retard the very readjustment of occupations and investments which is needed. *No such objection can be raised to the high taxation of land rent*, since such taxation is specifically intended to be independent of the use which any individual chooses to make of his land.

But in spite of the differences which analysis makes it possible to point out between land rent and other kinds of incomes, economists of the conservative school will doubtless continue to refuse to see any differences which tend to support special taxation of land rent as against such other incomes. And when asked to suggest, from time to time, how larger revenues may be secured for important governmental services, they will probably continue to look towards almost any other conceivable source rather than to advise increased taxation of rent.

³⁰ Such evils as result from changes in the *general level of prices* should be corrected, so far as possible, by stabilizing banking conditions and the value of the monetary standard.

§ 12

The Taxation of Inheritances

Let no one conclude that our argument tells equally against all inheritance on the ground that those who pay interest for the use of capital accumulated by previous generations are paying for a service to persons who did not contribute that service. For it well may be, in the case of inheritance of capital produced by human labor, that the prospect of descendants' reaping return from it is a condition without which, in great part, it would not be saved. If so, the interest is paid for a service which, except for the prospect of interest payment to descendants, might never have been rendered; it is paid for the use of capital which, except for expectation of reward to descendants, might never have been added to society's equipment. As long as the family affections endure in their present strength much of the happiness of parents will be realized only as they are permitted to work for the future prosperity of their children. General welfare and happiness would probably not be furthered by a policy which should entirely deprive parents of the privilege of bequest. Nor would the community probably get, in the long run, the use of so much capital, for less would probably be accumulated. A parent will be less likely to save and to invest his earnings in the education of his children if he believes society will appropriate all the gain and will not allow his children to reap a larger income for the larger service which such education enables them to render. And in like manner, a parent will be less inclined to save and invest in capital construction if he believes that society will allow his

children to reap no advantage in return for the service from such capital.

It is, clearly, illogical, then, to abolish the inheritance of wealth without abolishing at the same time all the advantages of nurture and education that the children of thoughtful, thrifty and affectionate parents have over the children of other parents. It is, in short, illogical to abolish the inheritance of wealth unless we also abolish the family and make all children wards of the state.

There is no intention to suggest, however, that inheritances should never be taxed or that the law of inheritance is not in need of modification. When, as at present, the state provides for inheritance of the property of intestate decedents by remote collaterals who have often been unacquainted with their unconscious benefactors, it can hardly be said that the policy adopted has been dictated by the necessity of encouraging accumulation or by the desirability of giving men and women the happiness of safe-guarding the future welfare of those for whom their affections are strongest. Also, so far as the existence of large estates is the outgrowth of a past when individuals have been allowed to receive large incomes which they have not earned, or so far as such estates may result from our inability ever completely to prevent the securing of ill-gotten gains, the regulation of the transmission of great estates or their high taxation may be the only means of avoiding the perpetuation of a most undesirable inequality. Even the transmission of estates honestly earned may properly be limited or regulated or the estates heavily taxed if the inequality resulting from their undivided bequeathal is likely to prove a danger to democracy.

But whatever may be the advantages to the general welfare of maintaining in considerable degree the right of inheritance and bequest, there appears to be *no reason to believe that to keep the major part of ground rent from going into the pockets of individuals would decrease the amount of land or the amount of any other capital.*

§ 13

Some Probable Effects of Making Land Rent the Chief Source of Public Revenues

If taxes were removed, for the most part, from other capital and were concentrated on land, several consequences would follow. The net returns to owners of capital would be greater, because less taxed, and this would mean a higher rate of interest to them on the value of their capital. If this higher rate of interest resulted in increasing accumulation, the rate might eventually somewhat decline. So long, however, as the net rate of interest remained higher than before, there would be two reasons for a decline in the selling value of land. Land would decline in value because the net rent to its owners would be reduced by the tax. And it would decline also because its future rent would be capitalized, for a time at least, at a higher interest rate. For the value of land, unlike the value of capital, has no relation to its cost of production. Land, as we have here defined it, has no cost of production. Its value can be arrived at only by knowing or estimating its future rent (or surplus yield over interest and wages) and capitalizing this future rent at the market rate of interest.

If, then, a piece of land is expected to yield \$100 a year for an indefinite future, in excess of the wages and interest expended in making use of it, and if the market rate of interest is 5 per cent., the land will be valued at \$2,000. A tax which should take each year \$75 from the \$100 previously left to the owner, leaving him a net rent of only \$25, would reduce the value of the land in as great a proportion, i.e. to \$500. The annual yield to the owner, after the tax, would be as large a percentage as before of the price at which his land could be sold. Hence he would have no more motive to sell the land than he had before and he would continue to do with the land exactly what he would do with it if there were no tax. The speculative holder of land, however, would find the tax a reason for not holding his land idle and, if he could not use it, would have to let it go to those who could.

But if the removal of taxation from capital means that the owner of capital enjoys even temporarily a higher net interest than before, because an untaxed interest, the fall in the selling value of land will be more pronounced. For the prospective \$25 a year of rent left to the owner if the land is taxed, which, if net interest is 5 per cent., makes the land worth \$500, will, if net interest is (say) 6 2-3 per cent., make the land worth only \$375.

Let us consider, now, the effects likely to be produced upon different classes by a change in the tax system which should remove the burden of taxation, in large part, from capital and commodities and concentrate it on land. The belief has been long held by many persons that farmers would regard such a system of taxation as bearing more heavily upon them as a class than upon

city dwellers. What evidence is available, however, seems to show that land values, at least in some of our states, *are much larger in proportion to improvement and building values in the cities than in the country.*³¹ Furthermore, many farmers are coming to resent being taxed on their improvements which constitute so large a proportion of their total possessions, while they see speculative holders of unimproved agricultural land, who are rendering to the public no service, paying taxes much lower and often insignificant.

The typical small farmer would very likely have considerable to gain from a system of securing public revenues which avoided taxing him on his buildings, machinery, stock, orchards (except the bare land), fences, drainage improvements and the fertility put into the soil by his own efforts,³² which avoided, also, taxing com-

³¹ See Fillebrown, *The A. B. C. of Taxation*, New York (Double-day-Page & Co.), 1909, Chapter IX.

³² For the purposes of taxation, it is not to be assumed, however, that the rental value of agricultural land, as distinguished from the interest on capital, necessarily includes only the rental value which the land might have if the exhaustible fertility elements of the soil were entirely withdrawn. In most cases the land would become unusable without some restoration of fertility elements, before this point had been reached. Land which has been so far exhausted that it will not yield to labor and to the capital invested in buildings, machinery, etc., the ordinary wages and interest, *unless its fertility is wholly or in part restored*, and which would therefore be abandoned if restoration were not feasible, might not be altogether without fertility elements capable of further exhaustion. *But no one could afford to live on the produce of his labor on this land*, while thus carrying the exhaustion further. The minimum of *practically* exhaustible fertility has been reached. If, now, a piece of agricultural land exhausted to this degree is so well situated that a would-be tenant could afford to pay rent for it, provided he were

modities of which he was a purchaser, and which taxed only the value of the unimproved land. His net annual

assured either a perpetual lease or, on termination of the contract, the full cost value of his refertilization, this rent would measure the rental value of the land as distinguished from interest on capital. That land which is so far exhausted as not to be practically usable without some degree of restoration, may nevertheless be so well situated as to yield, *if restored*, something in excess of the wages of labor and the interest of capital employed upon it, *including in "capital" the restored fertility of the land*, will be readily admitted. Such a yield is clearly *rent*.

Gas and oil wells and mines, like farms, are exhaustible. But they differ from farms in that exhaustion is necessarily permanent. The owner never replaces what he takes from them. There is, consequently, no problem of distinguishing between the rental value given by nature and any interest return on elements replaced by the owner. The rental value of the ore of a mine as distinguished from the interest on machinery, shafts, corridors, etc., is all, clearly, unearned (except so much as may fairly be conceded as reward to the discoverer of the mine for making it available somewhat sooner than it might otherwise be found—cf. § 5 of this chapter), and may be taxed with justice at a very heavy rate, perhaps up to 100 per cent a year. This conclusion need not interfere with a governmental policy designed to conserve mineral wealth for future generations. Either inducements could be made to owners to conserve, by a policy of remission or partial remission of taxes on unused mines (which policy might, however, offer temptations to speculative holding of some mines so inducing all the greater use of others, or to monopolistic restriction of output), or the government could buy mines outright for the purpose of conservation, being able to buy them more cheaply because of this policy of taxation than if private individuals were permitted to appropriate all the income from natural mineral resources. This will be an unwelcome conclusion to the owners of our mines of gold, silver, copper, lead, zinc, iron, coal, etc., but from the point of view of the masses it is a just conclusion nevertheless. For that a few men should be permitted to derive tribute from the remainder as a con-

returns would frequently be larger, although the selling value of his property would be smaller. Considered as a potential land speculator he would be worse off. But considered as a farmer who intended to remain such and to pass the farm on to his children, he and they would be better off. Such a farmer, if he owned his farm free of debt could accumulate wealth the more rapidly because of the assumed change. And if, previous to the tax change, the farm had borne a mortgage, the new system would enable the farmer more easily to get out of debt. Indeed, there seem to be a very large percentage of farmers who, with good management and industry, can hardly get incomes which amount to fair wages for their labor and interest on the cost value of their improvements. Such farmers *get no land rent at all*, or an insignificant rent, and, therefore, *would pay no tax at all if no property but land were taxed or would pay a merely nominal tax of a few cents an acre*. Those economists who favor confining increase of taxation of the rental value of land, to cities, for local purposes, might well be objects of suspicion to such farmers. For it appears often to be in the cities that the receipt of large incomes from the rental values of land is most important ;

dition precedent to the enjoyment by the latter of nature's subterranean gifts, tends neither toward equality of opportunity nor toward general wellbeing.

In passing, attention may be called to the fact that there is nothing in the scheme to tax land rent which need at all militate against the forestation of land. Under this scheme idle lands can be the more cheaply secured by government for forestation purposes. Under it, the additional value due to an individual's forestation goes untaxed. And under it, as now, special exemptions from taxation can be given, if it is believed that private forestation is of general benefit, to encourage such forestation.

and it is very clear that the high values of the city lots from which these incomes are drawn are sometimes due in great degree to the growth of enviroing farm communities. At all events, it may properly be asked why the large rental incomes from city lands may not be taxed to meet the cost of state functions in the benefits of which farmers share, as well as for purely local expenses.

But let us consider the case of the prospective farmer, or of the tenant farmer who desires to become a farm owner. To him there is a still greater benefit as to which there can be absolutely no question. For a tax on land or land rent causes land to be obtainable more cheaply than before. A farm the net rental value of which is \$100 a year is worth, capitalized on a 5 per cent. basis, \$2,000. But, as we have seen, a tax upon it of \$75 per year, leaving the owner \$25 while raising the rate of interest (unless and until the stimulus to greater saving again lowered the rate) to 6 2-3 per cent., would reduce the selling value of the land to \$375. The purchasing farmer would, to be sure, have to pay each year thereafter the \$75 in taxes, but this he could pay and more than pay out of the interest on his saving of \$1,625 in the purchase price, even if this interest remained only 5 per cent. For 5 per cent. on a saving of \$1625 would be \$81 $\frac{1}{4}$. And besides this, it is to be noted that the farmer would now get not 5 per cent. but, for a while at least, a net return of 6 2-3 per cent. on his investment in capital. Let it be noted that just as the acquisition of farms would be facilitated in the country so would be facilitated the acquisition of homes in the

cities.³³ But half measures will not suffice. To tax only future increases of land values is not very appreciably to cheapen land and so make the acquisition of

³³ There is no intention to argue that all land ought to be used when it is not all needed. Neither is it intended to deny that the holding of well-situated land out of use for a few years may sometimes render easier the possibility of a better use (See Fisher, *The Nature of Capital and Income*, New York, Macmillan, 1906, pp. 253-4), that speculation in city lots may yield a service by preventing land from being built on too soon and so saving it for prospective high buildings without necessitating the tearing down of old and lower ones. But if any economic waste is ever so avoided it is probably more than equalled by the waste involved in constructing longer streets, in walking and riding longer distances past vacant land by thousands of city dwellers and in transporting goods farther from store to store and from stores to homes than would otherwise be necessary. Individual estimates of gains and losses do not tend to result in the most economical arrangements when the gains and losses do not accrue to the same person. Furthermore, in practice, the notion that money can be made by speculation in real estate, probably operates as would a partial combination among holders of vacant land, thus forcing up rents and the price of land. Also, such unused land is raised in value not only by road and street construction but also by other improvements and services paid for from community funds. Hence to tell the owners of land that the improvements will be paid for chiefly by those owners who build upon and use their land, is not merely to avoid discouraging the speculative holding of land. *It is to offer a distinct encouragement to such holding.* As to those economists who argue that the free play of individual speculation in land will usually keep land from present use only if there are probabilities of a better future use (which the poorer present use is assumed to negative), would any of them deny that when owners who build on and use their land are therefore forced to pay higher taxes which in part are so spent as to increase the value of idle land, the tendency will be for land to be uneconomically and wastefully held out of present use?

farms and homes more easy. It is simply to prevent such acquisition from becoming more difficult. If such a tax is moderate it may not, in the long run, accomplish even this. In connection with this problem, attention may be called to a serious objection to the extensive use of the now very popular income tax. In so far as the income tax is largely relied upon as a source of revenue, land values tend to be relieved of taxation. As a result, the salable value of land is high; ownership of farms and homes becomes difficult except for the well-to-do; and tenancy is unnecessarily accentuated. *Thus, indirectly, may the income tax, which many have hopefully advocated as an aid to the attainment of economic democracy, prove to be an obstacle.*

To sum up, the change here discussed would remove heavy tax burdens some of which rest in large degree on wages; it would add to the net returns on capital; it would discourage speculative holding of land; it would make more easy the acquiring of land for production or for homes and so would facilitate the change from tenancy to ownership. Those who were ambitious to get farms and homes for themselves would have larger (because untaxed or less taxed) earned incomes to buy with, and they would not have to pay in advance, in a high price of land, the capitalized value of exploitation, although only in case all rent were taken in taxation would even unimproved land be obtainable for nothing. It may be added that a population of home owners would be a substantial bulwark against such irrational revolutionary economic changes as are advocated by many radical socialists. On the other hand, in a country where the few own nearly all the wealth and the many are but tenants or laborers possessing nothing except their labor,

a parasitic class can maintain the *status quo* under the forms of democracy only by corrupting the voters or their elected servants or by controlling the avenues of information.

There is no intention to argue that every farmer would find his tax burden lightened if land rent were made the principal or the exclusive source of public revenue. Some farmers there doubtless are whose incomes are in considerable degree made up of rent. But these are farmers who realize a good surplus above fair returns for their work and their investment in capital. These are farmers who can, as a rule, easily bear a heavier tax burden. Under our present system of taxation we tax the earned incomes—interest and wages—of farmers and of all other persons. We diminish the profitableness of making improvements in soil and drainage, of erecting buildings, of planting orchards, of accumulating machinery and stock. But we tax land rents so lightly as to leave land values, i. e., capitalized prospective rents, high, and so make it seem easy and relatively worth while for discouraged users of land whose labor and interest incomes are highly taxed, to sell their land and *live out their money*. In brief, our policy of taxation gives almost the maximum encouragement to speculation in land, keeps the price of land high and so makes it hard to acquire except by the wealthy few, keeps earned incomes derived from the use of land relatively low and tempts users of land to sell. We pretend to desire widespread ownership. We repeat unctiously the dictum of Arthur Young that “the magic of property turns sand into gold.” But we adopt a policy which works in the direction of tenancy.

Even those property owners whose personal pecuniary interests cause them to object to putting taxes chiefly upon land rent might well, perhaps, give thought for a little while, to the interests of their sons and daughters in case, as often happens through the mistakes, miscalculations and accidents of life, their family fortunes come to be dissipated and their children fall into the tenant class. Do such property owners wish to make economic rehabilitation and home ownership for their children, under such circumstances, as difficult as possible? Yet this is the consequence to be expected from high salable value of land. And just as it is much to be preferred that no one of us should be permitted to own slaves, rather than that, in case of misfortune, our children should be able to sell themselves into slavery, so likewise it is better far that the landed property of each landowner should have a smaller salable value than that the children of many of them should be able to sink into a tenancy made hopeless by high land prices.

Before quitting the general topic of this section, let us inquire what would be the effect, in any large community which should first adopt it, say the State of Missouri, of a tax system such as the foregoing argument suggests. Clearly, the value of land, as such, would rapidly fall. The mere speculative holder of idle land would not be able to collect the toll he now collects from those who desire to build homes or to launch business enterprises. The ownership of homes and farms would be made easier. The return on capital investment would be increased. Persons in other states who had accumulated capital would be more inclined to invest or lend it in Missouri. The inflow of capital would tend to an increase in the number of buildings and in the amount

of machinery, fruit trees, cattle, etc. The increase of buildings would eventually tend to reduce the charges to tenants. The increase of capital in general would tend to make labor more effective and to raise wages. Missouri would perhaps first become a more desirable state for the average capitalist to invest his capital in; but it would quickly become a more desirable state for the average non-capitalist to live in. The inflow of capital and of population, together with the force of example, would then be likely to start a movement for a similar tax reform in those neighboring states from which the capital and the population were flowing.

§ 14

Summary and Conclusion

At the beginning of this essay it was shown that land rent is fixed by the marginal productivity of land and is a surplus over the interest to waiting and the wages of labor, a surplus the amount of which cannot be increased by the owners of land to make up for the taking by taxation of any per cent. of it. The attempt was then made to distinguish briefly between rent of land and interest on other capital. The situation rent of land we found to be an absolute amount, not determined by the value of the land or by its cost of production, but an essential element in the determination of the value of the land. The value of reproducible capital, however, was found to be directly determined, in large part, by cost of production, analyzable into alternative returns of the productive factors used. The productivity of capital appeared to be an important influence, perhaps the most important direct-acting influence, fixing the rate of inter-

est. It further appeared that the interest on capital, when this capital is produced and saved by effort and waiting respectively, and when it is used in socially desirable ways, is earned. The interest is earned in the sense that the effort and waiting done by the producer and saver of the capital secure for the community as much of wealth as the capitalist receives in interest. On the other hand, the situation rent of land appeared to be a payment for benefits due to natural conditions or to social growth and not for services brought into existence by the owner of the land. Thus, the rest of the community is perpetually under taxation to support a class of landowners from whom, as such, no equivalent return is received. The landowner who has bought his land, though he has given an equivalent for it in value of something else, nevertheless cannot be said to give a service to those from whom he derives rent, which would not equally have been available had neither he nor any other landowner ever lived. When one person buys land of another, he simply buys the privilege of collecting a periodic income from the landless masses without giving any service in return. So far as these masses are concerned, the purchase of land by one person from another is but a change of masters, *a change of parasites of which the landless masses are the multitudinous collective host*. Hence the private receipt of rent violates the utilitarian principle that each should receive remuneration or income only in proportion to service rendered to those by whom the remuneration or income is paid.

In the course of our study, however, it became necessary to make certain criticisms. The so-called rent of land is not all an unearned income. Part of it is really interest on the cost of street-cutting, paving, etc., usually

met in whole or in part by special assessments on owners of contiguous land. Since these owners of land chiefly benefit through a resultant increase in the rental and salable value of their land, it seems just that they should bear special assessments. But the justification of their having to pay these special assessments depends upon their being allowed to receive, in higher rental value of their land, a return on the cost of the assessments. Various alleged services of city landowners, such as exercising control over the class of tenants in any locality, or seeking out, developing, and advertising new sites, were next considered. The first did not seem to be a service for which we are necessarily dependent on landowners, or, in any case, a service so costly to them in effort as to justify very much of rent. The seeking and advertising of new sites and bringing them into use at an earlier date than their advantages would otherwise be realized may sometimes be a service to the present generation, but is not clearly a service to later generations who would eventually, with growth of population, have taken up this land anyway. Hence, if this is a service justifying rent payment, it can justify such payment only for a limited time. It is like the service of an inventor who gives us, somewhat sooner than we might else have it, the benefit of a new idea in mechanics, and to whom we give a definitely terminable right to receive royalties. So, also, we were unable to conclude that the early settlers in the American West had rendered any such economic services as to entitle their descendants and successors to receive rent for all future time from the descendants of later comers. For there seemed no clear indication that any benefit was received or is being received by the later comers or their descendants, from either the present

or the former owners of the land. If the "benefit" of rising land values was "diffused" in any sense, the diffusion was not clearly to those of the present generation who now have to pay rent to use the land. They may well regard themselves, if they choose to recognize the authority in the matter of those who did it as "sold out" by a previous generation.

Nevertheless we concluded that increased value of land resulting from increasing population which forced down the margin of production ought not to be made an excuse for so taxing land rent as to leave with incomes smaller than their previously earned incomes families which, to avoid overcrowding their own land, had refrained from rapid multiplication. The increase of those whose habits or ideals would eventually tend toward general misery ought not to result in so reducing the available space for cultivation or in so increasing the tax on the land owned, as to greatly reduce the incomes of a non-parasitic class with ideals of a different sort. This last consideration, however, seemed to tell with but little force against the high taxation of city or near-city land, or of any land in a country not unduly crowded, since the value of such land is due mainly to increase of its special advantages rather than to a lowering of the margin of production.

A consideration of the probable effects of high taxation of rent indicated that such a policy would tend in the direction of wide distribution of home ownership and away from tenancy. Ownership cannot be stimulated by a policy which makes land high in price.

The argument that taxation of land values should not be much emphasized because there are other differential and unearned incomes, we concluded has little force.

Most other unearned incomes, such as those secured by monopoly and by industrial free-booting, require to be terminated, rather than to be continued in order that their recipients may be taxed. If there are other incomes of an analogous sort to land rent, the possibilities of taking them in taxation and the social utility of taking them should be separately considered. And in the meanwhile, the possibility of there being other unearned incomes is no more an adequate objection to taxing a kind of incomes we know to be unearned, than is the possibility of there being gentler ways of stealing, a reason why we should allow highway robbery to go on until we have reached an agreement about the proper way to deal with *all* forms of dishonesty. Let us not be too afraid of a transition period when we may somewhat discriminate between different sorts of unearned incomes. As to whether or how far it may be desirable, during a transition period, to levy sharply progressive inheritance taxes for the purpose of mitigating the inequality which has resulted in part from our long continued policy of permitting the private receipt of unearned wealth, or as to whether wholesale evasions of such taxes could be prevented, no opinion is here expressed.

To avoid the objection of infringement on "vested rights," some advocates of land-value taxation have proposed that only future increases in the value of land should be specially taxed. But this proposal seems to ignore the fact that purchasers often pay a higher price for land in the expectation of these very future increases. How then, can special taxation of these increases be anything else than an infringement of "vested rights?" In truth, however, too great a respect for the "vested rights" of individuals comes perilously near to meaning

no rights for society. It might be interpreted to mean that society could never modify any policy in the expectation of the continuance of which individuals had acted, without giving compensation. It might be interpreted to mean that when we undertake to regulate monopoly price, we must compensate the purchasers of monopoly stock, and that when we choose to remove tariff protection we must compensate holders of the stock of protected industries. If society is not bound to do these things, neither is it bound to go on, through all future time, paying landowners for services which not they but nature and society render. The community has frequently discriminated, in taxation, among different kinds of commodities and, therefore, among consumers of such commodities. It is under no pledge never to discriminate between land and other property. In some places a certain amount of such discrimination has already been practiced. Purchasers of land should be presumed to have bought their land on the understanding that tax systems may be changed in this direction at the option of the public. It may be desirable—as it is certainly altogether likely—that any great change should be made gradually, but that society, or the non-landowning part of society, because it has paid in the past for no service received, must either go on doing so forever or must buy itself free with no expense or loss to landowners, is a doctrine which even those who favor it prefer not to state, and doubtless will not now state, frankly and without equivocation.

APPENDIX

§ 1

Suggestion for Legal Enactment or Constitutional Amendment, Especially in States Having the Initiative and Referendum

Whereas, the possession by the few of great landed estates beyond the possibility of their own use is a principal source of inequality and a danger to democracy, and

Whereas, the value attaching to land apart from improvements is due rather to population growth than to the efforts of the individual owners, and

Whereas, the holding of land out of use for speculation or to aid monopoly operates to make land and home ownership difficult for the many, to diminish production, to lower wages, and to cause involuntary idleness, and

Whereas, taxes on buildings and improvements, including fertility put into land by the owner, and on other goods which are produced by labor, discourage improvement, increase rents, restrict the supply of the taxed goods and raise their prices; while taxes on the value of land force idle land into use, encourage improvement and production, reduce rents, enlarge earned incomes and increase the number of home owners, and

Whereas, taxes on the shares of stock of corporations, held by individuals, are almost uniformly evaded; while taxes on the mines, gas and oil wells, valuable sites and other landed property of these corporations would effectively reach their stockholders, therefore

It is hereby enacted that all taxes on buildings, machinery, cattle, fruit trees, growing crops, fertility put into the land by any owner or occupier and not yet practically exhausted, drainage improvements, stocks and bonds, money, and all other taxes except taxes on land shall be immediately reduced 20 per cent and thereafter by a like amount each year until they are completely abolished, and that the necessary revenues for state, counties, cities, towns, villages, school districts and other units shall be secured by a tax on the rental value of land exclusive of the value of improvements in, over or under such land; but, however small its value, no land held out of use shall be entirely untaxed, and

It is further enacted that all previous constitutional limitations on the rate at which land may be taxed, are hereby repealed.

Provided, however, that in any year for a period of fifteen years following this enactment, any person whose real estate is improved, is occupied as a residence, and does not exceed, in such year, \$10,000 in assessed valuation, or \$20,000 if it is agricultural real estate actually worked or operated as a farm, may, at his or her option, in lieu of the tax hereinbefore provided for, pay a tax on all his or her property which would be taxable under the previous law, at a rate, on the first \$5,000 of such property, of 8-10 the average rate paid by him or her to the various governmental units, state, county, etc., during the last — years preceding this enactment; at a rate, on the second \$5,000, equal to 9-10 of such previous average rate; and at a rate, on the rest of his or her property, equal to such average rate. But no option in taxation shall be given to any corporation, nor shall any option be given to any natural person as to payment of taxes

on land held substantially out of use, notwithstanding such person may live on such land in a tent or shack for less than two-thirds of the year. Nor shall any natural person have such an option as to more than an acre of land used for residence only, as distinct from farming, or as to two or more non-contiguous pieces of land.

And provided, further, that nothing herein contained shall operate to prohibit such taxation of estates transferred by bequest or inheritance, including gifts made in anticipation of death, as the legislative body may think desirable.

§ 2

Reasons for Proposed Program

The average man does not know much political economy. He persists in thinking that a scheme to substitute a tax on the rental value of land for other taxes is a scheme to burden the farmer and the small home owner and to relieve of taxation persons of wealth; and the classes interested in maintaining the existing system play upon this belief so as effectively to prevent reform. Proposals to exempt altogether from taxation small farm and home owners, violate fundamental principles and are undesirable. Such proposals, indeed, would probably meet popular opposition rather than favor. The very success of land value taxation in breaking up large estates and throwing land into the possession of many small holders might, in such a case, so reduce the number of taxable properties as to make impossible the securing of sufficient revenue. So, too, proposals for permanent exemption of any landowners, even of a

partial nature, are undesirable. We do not know what the governmental needs of future generations may be.

But those persons whose studies have brought them to the conclusion that a tax on the rental value of land would be a lighter burden on small farmers and home owners than present taxes, cannot very consistently object to an enactment which, in effect, *merely gives assurance that the proposed new system will, in its inception, so operate*. And it can be no objection to such an assurance, that it may make a desirable reform possible through preventing the misrepresentation of its probable results by an interested privileged class. Unless, indeed, advocates of land value taxation are willing to include some such assurance, in their program, to the small owners who are still numerous in America, and who are not, and cannot be expected to be, political economists, it is doubtful whether this most essential of all economic reforms can be secured for generations, if ever. And a mere assurance of a special rate of taxation for such persons, would not do, even if it were desirable. The assurance must be to the effect that their taxes under the proposed system will not be burdensome *in comparison with* their taxes under the present system. But if advocates of the taxation of the rental value of land are willing to include such assurance as a prominent part of their program, success may be near. The advocate of land value taxation need not then do all the explaining. His opponents will have the task of trying to explain to persons of common sense, that a reduction in their taxes will hurt them. How far will these opponents get in persuading home owners and working farmers that they should pay high taxes and the land speculators low taxes in order that land may be kept out of use and in order that

land prices may be kept high? If the owners of the sources of iron ore, the coal mine owners, and other big landed interests succeed for a while in blocking the way, it may be necessary to offer larger or longer-continued concessions to the small home owner and farmer. When, however, it becomes evident to these large interests that they are bound to lose and that delay may only make their loss the greater, their opposition is likely to weaken. At any rate, if some such program is adopted as has been above suggested, the politicians who choose to oppose the reform cannot successfully pretend to be so doing in the interest of workingmen, home owners, and small farmers, but must, tacitly if not frankly, admit that they are the spokesmen of the large landowners, including the powerful corporations which control our mineral resources.

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Chapter V. Wages and Population.

Chapter VI. The Rent of Land and Its Taxation.

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